UNITED STATES DISTRICT COURT

WESTERN DISTRICT OF WASHINGTON

UNITED STATES OF AMERICA,	)	
	)	
Petitioner,	)	No. 2:15-cv-00102-RSM
	)	
	)	
vs.	)	Seattle, WA
	)	
MICROSOFT CORPORATION, et al.,	)	
	)	Hearing on Petition
Respondents.	)	November 6, 2015

UNITED STATES OF AMERICA,	)	
	)	
Petitioner,	)	No. 2:15-cv-00103-RSM
	)	
	)	
vs.	)	
	)	
CRAIG J. MUNDIE, et al.,	)	
	)	
Respondents.	)	

VERBATIM REPORT OF PROCEEDINGS
BEFORE THE HONORABLE JUDGE RICARDO S. MARTINEZ
UNITED STATES DISTRICT COURT

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THE CLERK: This is the hearing on the petition to enforce the IRS summons in the cases of the United States vs. Microsoft, and the United States vs. Mundie, et al., Cause Number C15-102 and C15-103, assigned to this court.

Will counsel please rise and make your appearances for the record.

MR. WEAVER: James Weaver, Amy Matchison, and Jeremy Hendon, on behalf of the United States.

THE COURT: Good morning.

MS. EAKES: Good morning, Your Honor. Patty Eakes, on behalf of Microsoft.

MR. PRESTES: Brian Prestes, on behalf of Microsoft.

MR. ROSEN: Good morning, Your Honor. Daniel Rosen, on behalf of Microsoft.

MR. O'BRIEN: And Jim O'Brien, on behalf of Microsoft, Your Honor.

THE COURT: Good morning, all of you.

Counsel, just a couple of comments before we get started.

One, I know that all of the electronic equipment in our courtroom is on its very last legs. We are in the process of getting everything -- everything changed into digital format, which would be the state of the art. It's not going to happen in my courtroom until the very beginning of next year, but we're already on the way of doing that. So I apologize in advance if something fails. Hopefully, we'll have paper

backups so we can keep the argument going.

We've reviewed your briefing materials. I don't need you this morning to repeat what's in there. That doesn't help me very much.

Here's what I want you to do. I want you to break it down to the simplest, basic component parts for me; all right? Tell me -- frame the issue from your perspective. Tell me what the standard is. Tell me where that standard comes from. Are we talking about the statute, a rule, a regulation, case law? Tell me who has the burden. And then tell me what the facts show, from your perspective; all right? That will make the most sense for me.

Ms. Eakes, you are going to argue on behalf of Microsoft?

MS. EAKES: I am, Your Honor.

THE COURT: All right. And Counsel, what we'll do is, after Microsoft is done, we'll take a short break and then come back and do the second half; all right?

Ms. Eakes?

MS. EAKES: Thank you, Your Honor.

And thank you for saying that. I know the Court's already reviewed all the extensive briefing. I'm not going to cover all of the arguments in any great detail, but I intend to do what the Court has already set out. I'm going to focus on our statutory arguments, talk in short detail about some of the other arguments, and then talk about the broader policy

concerns that underlie our position.

We're here because the IRS has unilaterally decided to hand off the immense power that Congress gave it, the power to audit and the power to compel people to come in and answer questions under oath, under the threat of contempt if the taxpayer fails, to outside contractors. And the IRS's actions, as the Court knows, are really unprecedented. And the ramifications of what they've done are significant to every taxpayer in America.

Policy concerns about what they have done are these: By the IRS delegating their power and authority to outside contractors, including lawyers, the IRS is blurring the lines of accountability, and have empowered a private party, who may not share the agency's public vision and perspective, to take action against the taxpayer. These concerns are concerns that have been expressed in statutes, they're expressed in policy memorandums, and they've been expressed by the various courts, including the court in *U.S. Telecom*, which we cited in our brief.

We only need to look at the IRS's own policy statement to really understand why this is a significant issue. The IRS has been tasked with making impartial determinations of tax liability. We'll find out now if this is working.

When you look at the IRS's policy statement, which I've put up on the screen for Your Honor, it talks about the fact

that the policy is for the IRS to make an impartial determination of tax liability. And it says that, "An exaction of the United States government, which is not based upon law, statutory or otherwise, is the taking of property without due process of law, in violation of the Fifth Amendment of the United States Constitution. Accordingly, a service representative, in his or her conclusions of fact or application of law, shall hew to the law and the recognized standards of legal construction. Importantly, it shall be his or her duty to determine the correct amount of tax, with strict impartiality as between the taxpayer and the government, and without favoritism or discrimination as between taxpayers."

So when you look at what the IRS has been tasked with, and what the policy statement is, and when you think about the fact that the IRS in this case has decided to unilaterally hand off that power, this power, to an outside contractor, someone like Quinn Emanuel, there's really no guarantee that that contractor is going to share the same goals or mission, or that they match what the IRS has. Rather, the contractor's view might be like Quinn Emanuel's here; that their goal in litigation, or their attitude towards litigation, is that there's a winner, and there's a loser, and that they like to win, and that they do win.

Now, that's a significant policy issue, from Microsoft's perspective. And the IRS has characterized what they've done

in this case, in their decision to hire Quinn Emanuel and in effect hand off this power -- and it doesn't just apply to Quinn Emanuel; it applies to all contractors -- as trailblazing. And, in fact, it is.

And Microsoft's position is that if the IRS wants to trailblaze in the way that they've done here, and the way that they intend to continue to do, by letting contractors take compelled testimony and conduct audits, they need to ask Congress's permission first. But they haven't.

We already know that when Congress wants to hand off IRS tasks to outside contractors, they do it explicitly. And they did that when they passed a law that allowed private debt collection companies, collectors, to collect delinquent taxes. It was an explicit handing off of IRS tasks by Congress.

Now, not only does the IRS need to ask Congress, but they really need to do it in the light of day, which they haven't done here. They need to be transparent about what they're doing, they need to explain why they're doing it, and they need to get Congress's okay for what they're doing. Again, they haven't done that. And perhaps they didn't do it in this case because they knew that Congress would say no. Or if they didn't say no, at the very least they would be very concerned about doing that, for the reasons that Senator Hatch expressed in the letter that the Court has seen from the Senate Finance Committee, who expressed concern about involving private

contractors in what has traditionally been actions that Congress considers to be uniquely governmental functions. So whatever the reason, the fact remains that the IRS can only trailblaze in the manner that they have done here, and that they want to continue to do, with the consent of Congress.

Now, Congress is the one who decided, under 7602, that only the Treasury Secretary and other agency employees could audit and could take -- summon testimony from taxpayers. And the IRS can't ignore that statute. 7602 exists. Congress is also the one who decided that only the Chief Counsel can provide legal advice to the IRS. And the IRS can't ignore that statute either, which is 7803.

But instead of asking Congress, the IRS is here asking this court to bless what they've done so far, and what they intend to do in the future. And to be clear, we're not asking this court to police the IRS or to oversee what they're doing. But we are asking you to use your power and say that you aren't going to bless their actions by enforcing these summonses.

Enforcement of an IRS summons, as this court knows, is contingent on the Court's approval. Summonses are not self-enforcing, and the IRS needs you to bless it before they can proceed. Congress built this step in, because they wanted to ensure that there was a check on the IRS's power. And the Supreme Court has made it clear that it's appropriate for the Court to refuse to enforce summonses when it would constitute

an abuse of your process. So here, our position is, you shouldn't enforce these summonses, because, among other things, it would result in a violation of 7602(a)(3) and (a)(1), and a violation of 7603.

So I want to start by talking about these testimonial summonses and our argument with respect to that. And our argument is actually very simple and straightforward. And I've put up on the screen, as well as on the board, the statute.

Now, the IRS has clearly said that they plan to have contractors fully participate and ask questions in summons interviews if you enforce the testimonial summonses. But the law doesn't allow that. The statute is clear. If you look at it, it says that only the Secretary is authorized to examine books, papers, or records, to summon to appear before the Secretary, and to take such testimony.

Now, the statutes also define who the Secretary is. And that's 7701(a). And that defines the Secretary as both the Secretary and his delegates, which basically just means the employees of the IRS.

THE COURT: Can it also mean other contractors?

MS. EAKES: No. It can't be, Your Honor. If Congress intended for it to be outside contractors, as opposed to employees, they would have said that in the statute. And there's no cases -- and, in fact, the *U.S. Telecom* case is a perfect example of a place in which a court has said, you can't

be delegating -- you can delegate within, and that's fine, because you maintain the same kind of control over the process, shared vision, accountability, all the things that Congress wants when they give this power. But you can't delegate outside unless there's been an explicit authorization by Congress. So, no, it can't apply to contractors.

So 7701 is the section that defines who is encompassed in "the Secretary." And again, it means the Secretary or the employees or the delegates of -- the employees of the IRS, basically. And the language of the statute is very consistent with what the public policy is that you see in the cases; that certain governmental actions that require the exercise of discretion and judgment should only be done by government employees.

And the power that's conferred by 7602 is significant. And it gives the government the power to haul a citizen into court, using a summons, to compel them to answer questions under oath, with the threat of criminal and civil contempt if they don't comply. That's a really significant power. And given the awesome power that this statute confers, it only makes sense that the Congress would say that only IRS officials and their employees and government lawyers can do this.

So our position is that the language of 7602 is unambiguous, and that's the end of the analysis. Outside contractors cannot take testimony, pursuant to 7602. The

statute doesn't allow it, and we don't think you even need to reach the issue of the temporary regulation. There's no gap that was left by Congress. Their intention is clear and express, and that ends the analysis.

But, of course, as the Court knows, the IRS disagrees with Microsoft's reading of the statute. And they now say that the phrase "take testimony" is ambiguous; and that taking testimony really means hearing the testimony, not actually asking the questions. And so they enacted a temporary regulation that they say fills the gap, and that their interpretation should get deference from this court.

So I want to address each one of their arguments. First of all, the government's argument that "take testimony" means hear testimony, there are problems with that analysis -- or that interpretation as well. And if you go back to 7602, the primary problem with the government's claim that "taking testimony" means hearing testimony is that as -- if you take that interpretation, it causes Section 3, 7602(a)(3), to be meaningless. Because Section 2, to summon, to appear before the Secretary, basically, is already covered by the government's analysis that this actually means just authorization to who hears the testimony, as opposed to who asks the questions.

And as the Court knows, it's a real basic tenet of statutory construction that a statute has to be read in a

manner that gives meaning to all of its parts, and it should not be read in a way that causes the portions to become meaningless, which is what would happen if this court accepts the reading that the IRS is giving it, that "taking testimony" means hearing testimony.

But there's another problem with the IRS's position. And that's if you look at the contemporaneous documents, you see that what the IRS was saying -- before we ever walked into court and ended up in this litigation, they said that "take testimony" meant ask questions, which is exactly what Microsoft believes the statute means. So if you look at the temporary regulation and preamble to the temporary regulation, you can see -- and we've highlighted the key portions -- that before this litigation began, and when this regulation was passed, the IRS was saying exactly what we say 7602 means, which is that it's taking testimony by asking questions.

And the temporary regulation itself is consistent with Microsoft's interpretation; that "take testimony" means ask questions. The temporary regulation says that "fully participating" means questioning the person providing testimony under oath. That's what the statute means, and that's what the IRS thought it meant before we got to this place in litigation. That's what they were saying and what they believed when they passed this temporary regulation.

But it's not just the preamble in the temporary

regulation. If you look at the internal documents of the IRS, again, what they were saying, before anybody was looking, before anybody knew that this was happening, how did they interpret what "take testimony" means? There's nothing in any of the documents that show that they thought "take testimony" meant hearing testimony at that time.

And if you look at -- these are several documents from things that we appended to our brief and to our declarations. The regulatory signature package, again, these are internal documents. Microsoft has no idea this is happening. This is all pre-litigation. And they're talking about taking summoned testimony under oath, using the same construction that means asking questions.

Same thing in their justification for the emergency publication, these documents that came out of the administrative file, or what the government says is the administrative file, that "taking testimony" means asking questions of a witness. That's what they're telling their internal people. Regulatory information data form, another form that makes it clear that the IRS thought what they needed to interpret was that they were expanding who could take testimony, as opposed to defining that "take testimony" means hearing testimony, which is what they're claiming now. And similarly, in the executive summary, which is a document that they have to send among the highest levels of branches of the

government in order to pass this temporary regulation, again, consistent with Microsoft's interpretation that 7602, "take testimony," meant asking questions, not hearing testimony.

So in short, we think it's clear from the temporary regulation, the preamble to the temporary regulation, and the documents that the IRS has, as well as the language of 7602 itself, that it's clear, it's unambiguous, "take testimony" referred to asking questions.

But even if the Court disagrees and is concerned that there's some sort of ambiguity in the language of the statute, there is a second important principle that the Court should consider in deciding whether or not "taking testimony" means hearing testimony. And that principle is that when you're talking about agency delegations of authority, the case law is clear -- and this is the *U.S. Telecom* case -- that even in the face of congressional silence or ambiguity, agencies cannot delegate authority outside of the government without express authorization from Congress.

Again, that principle was very clearly articulated in the *U.S. Telecom* case, which I have on the screen. And the Court said, "We therefore hold, while federal agency officials may sub-delegate their decision-making authority to subordinates, absent evidence of contrary congressional intent, they may not sub-delegate to outside entities, private or sovereign, absent affirmative evidence of authority to do so."

Also in *U.S. Telecom*, they talk about whether or not as a result, if there is a delegation outside of the agency, that the agency should not get *Chevron* deference as a result of that. The mere silence, the *U.S. Telecom* court points out, does not mean that the agency has the authority to contract out or to delegate out their authority, which is precisely what the IRS is doing here by saying that 7602, and their authority to audit and to take testimony, can be given to outside contractors like Quinn Emanuel.

The concerns that are expressed -- I just want to talk about the policy concerns behind this, because it's what the *U.S. Telecom* case talks about; that there's concern about that this -- when you do that, when you pass your authority to outside -- people outside the government, you really end up blurring the lines of accountability. There are concerns about conflicts, and you're concerned about whether or not the contractors are acting with the same type of impartiality that's critical in IRS functions.

And all of those concerns are particularly important here when we're talking about Quinn Emanuel. We know -- and the Court saw evidence -- that there are clear conflicts. And there are reasons why Microsoft is concerned about Quinn Emanuel not acting with impartiality towards Microsoft, because, among other reasons, they represent our largest competitor, which is Google.

Now, I want to talk for a minute about the IRS argument that asking questions in a compelled interview is not an inherently governmental function. And I'd submit to the Court that they're simply wrong about that fact. There's nothing more inherently governmental than exercising discretion to question a witness who's been compelled to appear under threat of civil or criminal contempt if they don't comply.

Moreover, the IRS's distinction about this really doesn't make any sense. If the temporary regulation admits that it's an inherently governmental function to do things like deciding what information to be produced -- and that's what it says, in the text, or in the preamble to the temporary regulation, that that's how they -- one of the things they define as being an inherently governmental function.

That's exactly what you do when you take sworn testimony from somebody. It's not getting documents. The way you get information is, you make a document request, or a summons for documents. But the second way you get information is, you ask questions. That's what we do in deposition. That's what we do in court. You're making a discretionary decision about what information a person has to produce, albeit verbally, but it's the same concept as actually deciding what information has to be produced by writing it down and submitting the document request. And again, you're exercising your judgment and your discretion when you do that, which is why that's a function

that should only be kept within the government, to IRS Secretary and employees, as Congress has said.

And if you look at -- again, back to the contemporaneous documents, and you see, what did the IRS say these things meant at the time, when nobody was looking, and Microsoft wasn't involved, and we weren't involved in this litigation? They defined, in the temporary regulation, an inherently governmental function, under 7602, included deciding what information had to be produced. And if you contrast that with the Quinn Emanuel contract, which is what I've done on this slide, you see that they asked Quinn Emanuel to do exactly what we're saying is an inherently governmental function and is improper; identifying additional information that they deem is necessary; identifying and preparing new document requests; that they've asked the contractors to ask if they need additional materials, and the IRS will go out and get those things if they can. So looking at the contract and the temporary regulation, again, which are contemporaneous documents that were done before we ever got into this litigation, you see that by their own definition, the IRS gave to Quinn Emanuel precisely the functions that 7602 says are supposed to be reserved to the Secretary and to the delegates.

So I want to talk for just a minute now about the temporary regulation. And the Court knows that -- and to be clear, we don't think the statute is ambiguous in any way, and

so you don't ever need to reach it. But obviously, the IRS says that they plan on relying on the temporary regulation, and that that's their authority for allowing outside contractors to ask questions in these summoned interviews. That's what they told Microsoft. That's what they've made it clear that they intend to do.

So let's look at the temporary regulation. And it's our position that it's invalid for three different reasons. First of all, it fails step one of the *Chevron* test, for all the reasons that we just talked about. The statute is unambiguous. Therefore, there's no gap to fill. And therefore, it is invalid; that the temporary regulation -- or excuse me -- that 7602 is clear as to who it is that can take the testimony, or take summoned testimony, or ask the questions. And that's the Secretary and his employees.

But even if you assume that there is some sort of an ambiguity there, the temporary regulation still fails *Chevron* step two. And that's because it is not the product of reasoned decision-making. Now, the biggest problem is that the temporary regulation doesn't purport to explain that -- how it fits with the statute. So just on its face, if you look at the temporary regulation and the preamble to it, it makes no attempt to reconcile its language with the language of 7602. And that's a fatal problem. Because if you can't reconcile it, then on its face there is no reasoned decision-making.

There's also nothing in the temporary regulation that purports to interpret "take testimony" as being hear testimony; so, again, evidence that there isn't reasoned decision-making. Instead, what that temporary regulation says, and the preamble says, is that it's all about who can ask the questions. It's not about hearing the testimony. So that's another example of why it isn't reasoned decision-making, and it's invalid.

And the third reason why the temporary regulation is invalid is because they violated -- there was no notice and comment, and so they violated the requirement of 5 U.S.C. 553. That requires that there be a notice and comment process, even for this temporary regulation. And I'll tell the Court that that's not just a technicality. It's really an important democratic check on agency action. 553 and the notice and comment process is important, because it promotes reasoned decision-making. It makes executives accountable to people. And it's particularly important here, in this kind of situation, where the IRS admits that it's taking a trailblazing approach, it's trying to do something different. And the notice and comment provisions set up a system in which the people get to comment on what they're doing and decide whether or not it's a proper extension of their authority.

Now, the only time the IRS can get around notice and comment is if there's good cause; on a temporary regulation, if there's good cause. But that has to be articulated in the

preamble, and it isn't here. There's nothing in there at all about good cause for passing this temporary regulation. And we know that the IRS knows how to do that, and we cited in our brief some examples of other temporary regulations where they've given a justification for good cause. And here they simply didn't do that, because there isn't one.

The IRS says that 7805(e) exempts them from Treasury -- from temporary regulations from good cause requirement. And that's just wrong. All that provision does, 7805(e), is that it's a sunsetting provision. It sunsets the provision for temporary regulations that haven't been finalized after three years. It did not give the agency unfettered access or unfettered authority to bypass the notice and comment, as every other agency is required to follow. And the law on this, I think, is actually very clear. And I'd cite the Court to the *Intermountain* case, which I think makes it very clear that the Treasury still has to comply with the notice and comment provisions of the EPA.

Similarly, the IRS's claim that the temporary regulation is exempt because it's interpretive also lacks a legal basis. I think it's clear under Ninth Circuit authority, which is the *Hemp Industries* case, that any regulation promulgated pursuant to an agency's general legislative authority, which is what 7805(e) is, is a legislative regulation. And that's also consistent with the tax court's opinion in the *Altera* case,

which is unusual, because I think it was 14 of the tax court judges who joined in that opinion.

The preamble to the temporary regulation tells you that they're using their general authorization under 7805, because that's what they cite to. And we know that it has the force of law, because that's what Hoory's letter to Microsoft saying -- is the basis of authority for why they can have outside contractors ask questions. And I'd also remind the Court that the IRS can't, you know, propose post hoc grounds to support their notice and comment -- for failure to comply with notice and comment. All the documents that you have that were done contemporaneous show that they should have and they didn't comply with notice and comment. So for all of those reasons, we think that the Court should find that the temporary regulation that the IRS passed is invalid and refuse to enforce the subpoenas, to the extent they're relying on that temporary regulation.

I want to talk now for just a minute about our improper purpose argument and how we ended up here trying to enforce these -- or asking the Court not to enforce these summonses.

But before we do that, I just want to talk for a second about what we perceive to be the IRS's attempts to kind of paint Microsoft in a bad light, that we're scofflaws, that we're tax evaders, that we're doing something that people should be outraged about.

Just to be clear, I mean, Microsoft is challenging these summonses because we think they violate the law, and they were issued for an improper purpose, and because we think public policy is against what the IRS is trying to unilaterally outsource their power to outside contractors.

This isn't -- case isn't at all and this challenge isn't at all about Microsoft trying to hide anything. You have to remember that for eight years, prior to these summonses being enforced, the IRS and Microsoft were engaged in this audit process. From January 2007 until the summonses were issued, Microsoft had been fully cooperating with the IRS in providing documents, answering questions, making witnesses available, as they do in all audits of this nature.

This also -- there's -- Microsoft isn't trying to avoid paying its taxes either. It's totally prepared to pay its fair share of taxes. They're standing ready to do whatever they're legally obligated to do in terms of the payment of the taxes. But I think it's important, when you think about the improper purpose argument, to think about the facts and the audit itself.

So we say that the audit is over, and that these summonses are improper because they're not -- they're not really about the audit and getting to the right number. They're about helping Quinn Emanuel prepare for litigation. And the IRS says the audit is over. They're still trying to get to the -- the

audit isn't over -- excuse me. They're still trying to get to the right number. And these summonses, requests, are asking for information that they say they need. And obviously, it's going to be up to the Court to decide who's right and what conclusion the evidence supports.

But let's talk about what the facts are, in terms of the audit, as to why Microsoft believes that the audit is over and that these summonses are for an improper purpose. As I just said, the audit has been ongoing for eight years. There have been eight agreements by Microsoft to extend the statute of limitations. There have been 54 consensual interviews, in the United States and Singapore, during that time. There have been 150 transfer pricing information document requests that the IRS has submitted to Microsoft. There have been 375 total information document requests, and 1.2 million pages of documents that Microsoft has produced. So that's what the IRS was doing for eight years before these summonses ever came forward.

THE COURT: Counsel, am I not correct, though, that there is still not a number that has been agreed upon between Microsoft and the IRS; correct?

MS. EAKES: Well, there's not an agreed number between the parties. But certainly, the IRS has said it's reached its numbers and, in fact, has told Microsoft that it has a number. In fact, they've told them multiple times that

they have a number. They have both a primary number, that they gave to the IRS -- or excuse me -- that they gave to Microsoft back in 2011, and issued a 30-day letter because they had that number. Then, granted, they withdrew it. There was a whole flurry of additional activity. And then they said, again, that they had a number, which is when they met in January of 2014.

So, you know, if you look at why Microsoft continues to say they've already reached their number -- again, they reached the primary number. They have a secondary position. When they met -- the last timeline that Microsoft had, from 2013, this is what the IRS said was their timeline. They were going to be evaluating the information. They were going to present their conclusions to the taxpayer. This says November of 2013, and I think you saw from the declarations that that didn't actually happen until January of 2014. And then after that, they would have a dialogue and see if they could try to resolve it.

And when they met in January of 2014, the IRS presented Microsoft with a number. That was their number. It was the number on the Americas, and they said that they had a number for APAC, and that they were going to give it to Microsoft in a couple of weeks. So -- and then, of course, shortly after that, Microsoft said: Hey, we're not going to engage in any more discussions about settlement. Just give us the tax bill. Give us the number. You know, give us the finalization so we can move to the next stage, because this isn't productive.

Whether we're going to tax court, we'll evaluate whether or not we agree with your position, but let's just move to the next step. You're clearly done. That's why Microsoft thinks that it's over.

And everything that happened during that timeframe was consistent with that. It was really only after Microsoft said: No, we're not going to engage in settling it. You've given us your number, but you want us to accept your number, and we're not prepared to do that at that point. What we later find out is that that's when Quinn Emanuel was engaged. And it was after that point that suddenly, even though we've been told up to this point, "We've got your primary. We've got your alternate positions," all of a sudden they're saying, "Here's a bunch of additional information requests. We still need more information." And now they come in and tell the Court, "Oh, no, no, no. We don't have a number, and we never got to a number, and we need this information." But the only time that the request came was after Quinn Emanuel was engaged, and there was a lot more activity.

So we think, you know, using your common sense, circumstantial evidence -- granted, there's no one piece of paper that says that we're right and that the IRS is wrong. But we think all of the evidence supports exactly what we've said, which is that they've had a number. They've had a couple of numbers, a primary number, a backup number. And they've

said that they're done with the APAC. They have a number for that, and that it's actually over.

But there's also some evidence to suggest that the summonses themselves, I would argue, suggest that this isn't about getting to the right number. It's about getting a litigation advantage. And I think you particularly see that with respect to the summons that's for Steve Balmer. I mean, the Court has to ask itself, after eight years of auditing Microsoft -- now nine, but eight at that time -- why is it that the exam team, in all of those eight years, with all the people that they interviewed, never thought that Steve Balmer was an important witness for them to talk to? It's only after Quinn Emanuel comes in, and we start down what appears to be an entirely different path, which is preparing for litigation, that Steve Balmer is suddenly a critical witness in this audit.

The Court may know and be familiar with the fact that it's not unusual, in high-stakes litigation, for private law firms, or people involved in high-stakes litigation, to try to put pressure on their opponent by doing things like asking to depose the CEO. It certainly doesn't seem consistent with the claim that they're still auditing and that they're still trying to get to the right number.

But not only that, I think, also, the Court can look at the documents themselves; again, contemporaneous document, done before we got into this litigation, while the IRS thought

nobody was looking. And nobody was, frankly, at that time. What do they say about why they hired Quinn Emanuel? You can see -- and this is a document that is in Exhibit 4 to the Rosen declaration on reply, I believe -- that they said that they're an outside expert needed to evaluate and help prepare the case in anticipation of litigation. That's what Quinn Emanuel is about. That's what the summonses are about. It's about preparing for the litigation. And that's an improper purpose, under the statute, and that's the reason why you shouldn't enforce them.

One more point on this in terms of what the evidence shows. And that's that if you look at who they're actually vetting -- and again, this is in Exhibit 4 to the Rosen declaration on reply -- you'll find that in the IRS's funding request package to get the funds to pay for Quinn Emanuel, there's a market research survey. And they're vetting five other legal teams that the IRS is considering, and ultimately rejected. And all of those legal teams involved well-known trial lawyers with courtroom expertise, not tax lawyers, not people who have experience in transfer pricing. They had David Boise, a self-proclaimed Microsoft slayer; Ted Olson, from Gibson Dunn; Ted Wells, from Paul Weiss; Evan Chesler, from Cravath; and Sullivan & Cromwell.

What all of those lawyers shared, and what John Gordon and John Quinn shared, is that they're trial lawyers. And

that's -- just as you see in this document, Slide 16 -- is exactly what this hiring of outside counsel was about. It was about in anticipating of litigation. And these summonses are about getting an advantage and -- in the tax court and preparing the case for tax court. And that's an improper purpose.

So in summary, I would just say that on this point about what the purpose is -- because, again, there's not one piece of evidence that's going to tip the Court one way or another, but I think it's the constellation of evidence that I've just laid out for the Court. But it's also the fact that in order to believe the IRS's claim, that they really are still auditing, and they really are just trying to get to the right number, you have to believe that when they sat down with Microsoft, back in 2011, and, again, most importantly, in January of 2014, and they said, "Here's our number. We want you to pay it" -- you have to believe that at that time, even though they said that, that -- and they were willing to accept the number that they gave to Microsoft -- that somehow that really wasn't the right number, or that they were really trying to still get to the right number. And I think that just really stretches credibility, to believe that that's what was happening, and that it was still an open audit and an undetermined number.

I want to just shift for a minute and talk about kind of our alternative argument, which is, you know, to be clear, we

think that the summonses were issued for an unlawful purpose and to conduct pretrial discovery. But even if you give the IRS the benefit of the doubt, there really still is a problem. And that's because if Quinn Emanuel is, in fact, conducting the audit, that too is a statutory violation.

I can't remember if I put this slide back in here.

Again, if you go back to 7602, you can see that the statute authorizes only the Secretary to examine any books, papers, or records. And as we've laid out for the Court in the brief, "examine," in IRS parlance, means to audit, basically. And that's what the statute says. And really, it's not a question as to whether that's what it means, because the IRS concedes it as well. If you look at Page 20 of their brief, they say that the power to examine books and records is inherently governmental. That's the power to audit.

THE COURT: Counsel, let me ask you this.

MS. EAKES: Sure.

THE COURT: Are you arguing that any third-party contractors hired by the IRS would be unlawful?

MS. EAKES: No.

THE COURT: They can do that?

MS. EAKES: Yes, they can.

THE COURT: What makes hiring Quinn Emanuel different than any other third-party contractor?

MS. EAKES: Well, it depends on what role they're

playing, Your Honor. And certainly, the IRS can hire outside contractors to get help, and they do, on things like an outside economist. But there's a difference between having a contractor that is helping you in the process of the audit and someone who's actually stepping into your shoes, which is what's happening here with Quinn Emanuel.

THE COURT: All right. Well, let me ask you this.

Looking at that section right there that you've got, and you've got it on the screen, broken down into three separate pieces; right?

MS. EAKES: Right.

THE COURT: Can a third-party contractor examine any books, papers, records, or other data?

MS. EAKES: Yes. But they can do that under 6110 -- oh, 6103. Sorry. Thank goodness I have counsel who knows the numbers better than I do.

And we cited that. I didn't prepare a slide on it here. But 6103 is specifically a statute where Congress said -- or it -- the regulation that allows an outside contractor to examine, meaning to get a copy of it, to look at, to receive it. So, you know, that 6103 is entirely different than what you're talking about under 7602. But that hopefully answers the Court's question. So if the IRS wants to go out and hire an economist, give them copies of the taxpayer's information, so long as they comply with 6103, they can do that, and it's

entirely proper.

THE COURT: Here, can they do the same thing with Quinn Emanuel, let them examine books, papers, records, or other data of Microsoft?

MS. EAKES: They can let them under -- well, if the Court means "examine" in terms of conduct the audit, is what we're saying, can they look at the documents as a contractor, under 6103? Yes, as long as, again, they comply with everything under that statute. But what they can't do is examine, meaning they can't perform the audit themselves. That's what we say they're doing.

THE COURT: Can they suggest questions for the IRS to ask?

MS. EAKES: Yes, they can suggest questions.

THE COURT: Can they be in the same room when that examination is taking place?

MS. EAKES: Yes.

THE COURT: So --

MS. EAKES: They just can't ask the questions.

THE COURT: So if you've got a lawyer for the IRS, right, that's one of the delegates of the Secretary in the room, you've got Quinn Emanuel lawyers reviewing all the data, all the documents, they're listening to the testimony, and they've got a notepad, and they write down the questions, and they hand it over to the IRS lawyer, then it would be fine?

MS. EAKES: Yes. And let me explain why, because you're looking at me skeptically.

And I think that the important difference, Your Honor, is that suggesting questions -- the important check there is that you still have the IRS lawyer there who is the person who has to exercise their discretion and judgment as to whether or not to ask that question. And that's the difference between helping and suggesting. I mean, they can write a question, and the IRS lawyer, who, again, has a different policy statement, a different mission, that shares the view of what the agency's vision and perception is, that person has to decide: Do I ask that question or not? That's the exercise of judgment and discretion that we're talking about here.

So, yes, they can sit in the room. They can write the questions. But it's not a silly distinction. It's the difference between helping and the difference between doing. And when you're doing, which is what they want Quinn Emanuel to do here in this situation, under the temporary regulation, you're no longer helping. You're performing the functions in violation of the statute.

So in terms of the issue of whether or not they're participating in the -- or whether or not they're conducting the audit, we think the evidence shows that Quinn Emanuel is actually conducting the audit. And the reason that we say that is, again, if you look back at the contemporaneous documents,

and you look at the Quinn Emanuel contract -- and this is the distinction that I'm talking about. This is -- what's described in the contract is precisely what the IRS has to do. They have to perform a thorough initial factual, economic, and legal assessment of the record and theory. They're supporting continued development, analysis, and evaluation. They're assisting with further factual development. They're identifying and preparing new document requests, and they're preparing for participating in interviews, and they're performing independent research.

All of those things are a description of what the IRS has to do in order to perform an audit. And so if you believe the IRS that the audit is ongoing, the role that Quinn Emanuel is playing in it is a violation of 7602(a)(1). Because that means that they're not helping with the audit, they're actually performing the audit.

Now, we know that the IRS has said, "No, no, no. They're not doing that. They're helping, and we're actually supervising them." But again, I think if you look at the evidence, the contemporaneous evidence, the evidence that happened before we came into court, what you see -- and this is at the Rosen declaration, Exhibits P, Q, and R -- is that John Quinn -- or excuse me -- John Gordon, who's attending these interviews, he isn't being supervised by the IRS. He's out on his own. He's representing, first of all, that he represents

the IRS, which is in direct violation of the law. But he's also unchecked in terms of the way that he's asking questions; and again, the difference between a situation in which you're helping and a situation in which you're actually performing the tasks.

So if you conclude that the summonses weren't for the purpose of preparing for trial, but instead that Quinn Emanuel's conducting the audit, you still shouldn't enforce the summonses, because doing so would result in a further violation of 7602(a)(1), which is the provision about examining or conducting the audit, which restricts the auditing itself to the Secretary and to his employees.

And again, I think it's important to talk about the public policy reasons behind that. The agency's mission -- as we talked about, the IRS's policy and their mission is not to just push the edges of the law, and it's not to maximize the collection for the IRS. Instead, their mission statement is that they're basically to find the right number, as you can see from the policy statement. And the reason that is is because the law trusts that government employees, who have the right -- or the -- they follow the mandate of what Congress and the government wants. They trust them with finding the right number, you know, kind of in the same way that you trust prosecutors to be people who are tasked with doing justice, as opposed to just winning.

So let me talk for just a minute about our statute of limitations argument. Now, Microsoft's position is that the summonses were the result of the IRS asking and obtaining statute of limitations extensions from Microsoft, while they were hiding the fact that they were engaging Quinn Emanuel. And the IRS's response is, "Hey, the statute of limitations issues aren't relevant here." And they think that the law supports them on that. And I'd just suggest to the Court that the IRS really kind of misses Microsoft's point with respect to the statute of limitations, because our point is more fundamental than that.

Your Honor, as a starting point, you have to remember that our tax system is largely a voluntary system. And what I mean by that is that we expect people to determine what their taxes are and to pay it, to report their income properly, and to properly calculate it, and to pay the money that they owe. You know, said another way, our system is not based on -- most of the taxes don't come in as a result of enforcement. They come in as a result of voluntary actions by taxpayers.

Because it's a voluntary system, Congress understands that there has to be a certain level of trust and respect between taxpayers and the agency. And you can see that in the letter that we provided to you from Senator Orrin Hatch to the IRS, where he talks about the fact that it's -- the tax system is based on voluntary compliance, and the integrity of the tax

administration process and protection of taxpayer rights is of paramount importance. It goes on to say, "To those ends, Congress put in place specific restrictions on government action in the examination process. One such restriction is the requirement that only Treasury officials carry out certain examination functions, such as taking sworn testimony from taxpayers."

And he makes the policy point that I keep talking about, which is that unlike private contractors, the Treasury Department officials are required to swear an oath to the Constitution, and are subject to rules of conduct and federal law regulating their interactions with taxpayers. It's one of the core reasons, he says, that Congress limited these certain functions to people who are accountable within the government.

This principle, that we hold our public servants to a higher standard, is not just something that Senator Hatch says, but something that you also see in the case law. That's what the *ESM* and the *Deak-Perera* case are about, is that they support the same policy, which is that regulatory actions, our citizens are owed a higher duty of candor from our public employees.

It's really uncontested here that the IRS was not transparent with Microsoft when they were asking for these statute of limitations extensions. They don't contest that they got the extensions without telling Microsoft about what

they were doing with Quinn Emanuel. But that's not really -- that's not the only deception that the IRS engaged in.

THE COURT: Well, before we move from that one, I just want to make sure.

You're not telling me that there's some law, rule, or regulation that would have required the IRS to disclose its plan to use Quinn Emanuel; right?

MS. EAKES: No, I'm not.

THE COURT: All right. So you keep saying that they kept hiding the ball. That goes towards, again, constituting bad faith on their part?

MS. EAKES: I would say -- I don't even know that you have to phrase it as bad faith, Your Honor. I guess our point is that, you know, what the case law recognizes, what the courts require, is just a higher level of candor. So while they might not technically have a duty to tell Microsoft what's happening and that they've hired Quinn Emanuel, the fact that they didn't tell them is definitely contrary to what the cases recognize in terms of a duty of candor towards citizens or taxpayers, and specifically with the IRS. The --

THE COURT: How do you say that's equivalent to what happened in *Deak-Perera*?

MS. EAKES: Well, certainly, that case was something more, one would say -- could be considered to be more outrageous conduct. But I think that, you know, you have to

take the IRS's behavior, not just about the statute of limitations, but you have to combine it with some other things that they've done that I think illustrate the attitude that was there.

And that specifically is the fact that, you know, they not only don't tell them at the point they get the statute of limitations, but then even after they continue to not be transparent with Microsoft about what's happening. When they finally disclose the fact that they've hired Quinn Emanuel, and Mr. Bernard asks, you know, "Do you have an engagement letter?" Their response is, "No, we don't have an engagement letter," which Mr. Hoory tried to explain to the Court. But his response was really just, "Well, they're sophisticated. They know the difference between an engagement letter and a contract. And they didn't ask for the right thing, and so I didn't tell them." And I think that, you know, you combine that -- and they asked, you know, "Give us the whole contract. We went out and found there's a contract. Give us the entire contract." And instead, they only get a portion of it that doesn't really represent all of what Quinn Emanuel was doing.

Now, those things happened, of course, after the statute of limitations request. But I think that, you know, the point that we're making is that all of that conduct together is troubling. And it should trouble this court that as government employees, who have this higher duty of candor, that they

weren't candid with Microsoft about what was going on. And, you know, the law supports the idea that the Court has discretion and authority, in that situation, to decide that you're not going to enforce the summonses because of the behavior of the IRS, in this situation, and not being transparent in the way that we argue that they should have been, even understanding that they didn't have -- that there may not be a technical requirement that they have told.

Unless the Court has any other questions on that issue, I'm going to move on to the final issue, which is, I want to talk about our argument with respect to legal advice, which is that our position is that if the Court enforces these summonses, it's going to continue a violation of 7803(b). And under that law, the Chief Counsel has been vested with the exclusive authority to provide legal advice to the IRS, and to delegate that authority to his employees, whom by statute only report to him.

And there are unique and important reasons why the IRS should only get its legal advice from the Chief Counsel, and not from outside lawyers. First of all, they can't be hired or fired by the IRS. They're accountable to the Chief Counsel, who reports indirectly to the President. And importantly, the Chief Counsel doesn't report to the IRS audit team. They report to the Chief Counsel, who reports to the executive branch. And there's no question here that the IRS is getting

legal advice from Quinn Emanuel, and not from the Chief Counsel.

Sorry. Lost track of my slides there, Your Honor. I apologize.

You know, like I said, there's no question that they are receiving advice from Quinn Emanuel. They admitted in their response pleadings, and their contract with Quinn Emanuel, at Page 7, tells them that they are asking Quinn Emanuel to give their legal assessment of the case and their recommendation.

And so you might ask, why does it matter where the IRS gets its legal advice from? And it matters for the same policy reasons that I mentioned before, which are accountability and sharing the same public vision. If you look at the mission statement of Chief Counsel, you see from this slide that their obligations are that they're required to serve the American taxpayers fairly and with integrity. They're told that their mission is that they're to provide an impartial interpretation of the IRS laws; and that the reason that they're to interpret the laws impartially is so that taxpayers will have confidence that the tax law is being applied with integrity and fairness. And that's important. That's a unique feature -- or a unique direction that had been given to the Chief Counsel on behalf of the IRS, who are the exclusive legal adviser to the IRS.

And if you contrast that, again, with Quinn Emanuel's statement about who they are, that they think there's a winner

and a loser, and that they know how to win; and that's very different than what the Chief Counsel mission is. And to be fair, I mean, Quinn Emanuel probably isn't any different than any other private law firm that serves clients and wants to get the best results, and money is involved, of course wants to get either the maximum for their client, or have their client pay the least amount of money. And while they might be serving the IRS as a client, they have other clients as well. And those clients may have goals that are inconsistent with the mission of the IRS.

And that's really the concern here about the IRS getting legal advice from Quinn Emanuel, as opposed to following the statutory setup, which is supposed to be that they receive all of their legal advice from the Chief Counsel. It's a very different attitude that Quinn Emanuel has than the mission that you see for the Chief Counsel. And I analogize it to this, which is, you know, like the Washington state prosecutor, under the RPCs, we know that the prosecutors have the responsibility to be ministers of justice; that it's not simply about being an advocate. And said another way, the prosecutor's obligation, as you know, is to do justice. It's not to win. And of course our prosecutors listen to their victims, and they listen to the law enforcement officers that they're working with and the agencies who have investigated cases. But in the end, the way the prosecutor exercises their discretion and their judgment is

to make sure that justice has been done, even if that means that they didn't win. And that's really the structure that Congress has set up in a very similar way for the IRS. The mandate is to be impartial, not just to maximize the results. And we want our taxpayers to have confidence in the integrity of the system, and that's why it's been set up that way.

You can also see that view that Congress has about how the Chief Counsel or the IRS's lawyers are supposed to behave by another statute, which is that they -- 6110(i), which in that statute Congress has said that the advice that Chief Counsel gives to the IRS actually becomes public. That's a code provision that provides it. So it's not a situation in which most of the time, in private practice, your advice that you give to clients would never be disclosed. But Congress has said, specifically with the IRS and the Chief Counsel, that advice, when they give formal advice, it's going to be public. And that's an important public policy concern.

And so the problems that exist with the IRS getting their legal advice from Quinn Emanuel, as opposed to getting it from the Chief Counsel, are three things. It violates the statute, 61 -- or excuse me -- the statutes that set up that Chief Counsel is the exclusive legal adviser to the IRS. It bypasses the regime under 6110, which is to make the advice public, because Quinn Emanuel's advice isn't going to be public. And most importantly, it eliminates the concept of accountability

that the *U.S. Telecom* case talks about, and what Congress intended when it set up the statutory scheme.

So our concern is that if the summonses are enforced, the summoned documents and the testimony is going to be used by Quinn Emanuel to continue to provide legal advice and violate the statute; and so, therefore, enforcing the summonses would be an abuse of this court's process.

So I just kind of want to quickly recap our position. And I've put this up on the board that -- what our arguments are.

With respect to the testimonial summonses, the IRS -- or excuse me -- Microsoft believes that they're unenforceable, because they would cause a violation of 7602(a)(3), which restricts the taking of testimony to the Secretary and their defined delegates. In addition, we believe that all of the summonses are unenforceable, because the purposes of the summonses was improper. It was to prepare for litigation, as opposed to the statutory reasons why the IRS can use a designated summons. Secondly, that enforcing it would further a violation of 7602(a)(1), which restricts the auditing to IRS and the Secretary and the defined delegates. And third, that the summonses resulted from the improper extension of -- improper gaining of the statute of limitations extensions. And fourth, that enforcing the summonses would result in a further violation of 7803(b), which provides for where the IRS can get the legal advice from.

Now, as I said at the outset, the IRS wants to take a trailblazing approach. And we're not saying that they can't do that. But when they -- the trailblazing approach involves delegation of governmental power, the law requires the IRS to ask Congress for permission to do that. That principle is built into 7602, as I've said, that authorizes only the Secretary or his delegates to take testimony and to conduct audits. And it's built in the concept of 7803, which only allows Chief Counsel to give legal advice.

But Microsoft isn't the only one who's concerned about what the IRS is doing in terms of involving contractors in audit functions. We know that the Senate Finance Committee is concerned about it and -- from the letter that you have from Senator Hatch. And, you know, just this week we know that other taxpayers are concerned as well. The media was reporting that taxpayers believe that a ruling for the IRS in this case is going to open the floodgates to contractors meddling in internal revenue functions. In contrast, refusing to enforce the summonses here, and ruling for Microsoft, would really leave the status quo intact.

The concerns that Microsoft has been talking about I think are best summed up in this quote from the *U.S. Telecom* case that I've put on the screen. And it says that, "When an agency delegates authority to its subordinate, responsibility, and thus accountability, remain with the federal agency. But when

an agency delegates power to outside parties, lines of accountability may blur, undermining an important democratic check on government decision-making. Also, delegation to outside entities increases the risk that these parties will not share the agency's national vision and perspective, and thus may pursue goals inconsistent with those of the agency and the underlying statutory scheme." And that's really at the heart of what Microsoft is concerned about with the IRS's conduct in this case.

Again, we're not saying that the IRS can't evolve and take novel approaches. But when congressional approval is needed, as it is here, they need to seek it. And here they didn't seek Congress's approval. They didn't even get the necessary public input through notice and comment and rule-making. Instead, they engaged in what we consider to be a secretive and private process, and now they're asking the Court to give what they've done a stamp of approval. We don't think that the law allows the IRS to involve contractors in this way, and that's why we're asking the Court to deny the enforcement of the summonses.

And unless the Court has any questions, I'll sit down.

THE COURT: Ms. Eakes, thank you very, very much.

MS. EAKES: Thank you.

THE COURT: Mr. Weaver, it's my understanding you'll be the one arguing on behalf of the IRS?

MR. WEAVER: Yes, Your Honor.

THE COURT: Let's take 15 minutes for our court reporter, and we'll come back for your presentation.

(Recess)

THE COURT: All right. Counsel, we're back in session.

Mr. Weaver?

MR. WEAVER: Yes, Your Honor.

THE COURT: Mr. Weaver, let me ask you something.

At the very outset, I indicated that I wanted the parties to break this down to its component parts. It helps me conceptualize it all a little better.

Ms. Eakes made a very impassioned argument on behalf of her client, pointing out all of the reasons why the IRS hiring Quinn Emanuel to do -- to perform the duties that they've been asked to perform here is bad policy.

Is that what I'm looking at today? Am I supposed to decide whether it's good policy or bad policy?

MR. WEAVER: No, Your Honor, it's not. And that's one of the things I want to touch on. There are really three overarching things that I want to emphasize this morning for you. That's certainly one of them.

This is not an audit oversight proceeding. This is an armchair quarterbacking about how the IRS conducts its audit. So complaints about the length of the audit, complaints about

the choice of contractors, looking to internal policies, that is inapposite to a summons enforcement proceeding. And I'll talk about the Chief Counsel statute before I finish.

Even looking to that, that doesn't -- that statute, even if the IRS were violating it -- and they're not, because the statute doesn't say that the Chief Counsel is the exclusive attorney for the IRS. It says it's the attorney. And I'll explain that later. But that doesn't give them a right of action, to try to have a summons not enforced by the Court.

So that's one of the things I wanted to make sure I emphasized, is that this is, in fact, not an audit oversight proceeding. In the briefing, they refer to things like priority court guidance plans and internal revenue policies, internal revenue manual. None of that gives them a right of action to come in and demand that the Court do something about it.

Another thing that I want to emphasize, just an overarching theme, is that they have framed the argument -- Microsoft has framed the argument, the overall argument, of why we're here incorrectly. In its reply, Microsoft starts off saying the following. "The IRS agrees that the summonses are unenforceable if the IRS issued them for an improper purpose, or if enforcing them would otherwise abuse this court's process." That's wrong. That's not even the Ninth Circuit precedent, and we certainly didn't say that.

What the Ninth Circuit has said is that even the coexistence of an improper purpose would not prevent enforcement of the summons if the existence of a legitimate purpose was not rebutted by the taxpayer. So that's the standard, Your Honor. If we have a legitimate purpose, then the summonses should be enforced. And I'm going to talk a little bit more later on about the cases that are cited below, the Ninth Circuit binding precedent of *Stuckey*.

The third thing that I want to just emphasize at the outset is that Microsoft has pieced together things from the record that it could find and speculated about a story that isn't actually true. And the case law in the Ninth Circuit is very clear; that Microsoft, or any taxpayer seeking to not have a summons enforced, carries a heavy burden of disproving the actual existence of a valid civil tax determination purpose. That's the *Jose* case in the Ninth Circuit.

So what we've seen over time in this case is a series of speculation that's been proven inaccurate. It was originally proposed that the regulation at issue here, one of the things at issue, was created for the Microsoft audit. That has been demonstrably shown not to be the case. Originally, I believe there was some suggestion that the IDR requests, from which the summonses flow eventually, that they were crafted with input from Quinn Emanuel. That turned out not to be correct. There was a suggestion during the evidentiary hearing that there was

some sort of secret deal, with Quinn Emanuel, to front load its 2 million-dollar contract, so that when it later, if it went to trial somehow, they would be compensated up front. That's incorrect either. In fact, we will take a look at some documents today along that line. And in the last round of briefing, Microsoft compared the Boies and the Quinn Emanuel contract and said: Ah-ha, the Boies contract is different. It's smaller. It only has to do with case evaluation. Therefore, the Quinn Emanuel contract, which includes case assistance, that must be evidence of improper purpose, of going to litigation.

Well, the facts are, and we've put it in the record through Mr. Hoory's declaration -- the facts are that the Boies contract was smaller, not because the IRS wanted it to be smaller at the time, but because that's what they could get in the budget process during that fiscal year. The Boies contract preceded the Quinn Emanuel contract and was approved in the preceding fiscal year. So all of this speculation does not meet the heavy burden that Microsoft has, to cause the Court to not enforce the summonses.

Now, let me just step back a second. We're here about enforcing summonses that go to one of the largest audits in the IRS's history. Billions of dollars are at issue. You heard Mr. Hoory talk about how the IRS wanted to redouble its efforts and take a different approach in light of Microsoft's protest,

which accused the IRS work to that point of being arbitrary and capricious, and in light of the tax court case, *Veritas*, which had criticized an exam of a transfer pricing case, saying that that exam had been arbitrary and capricious.

So there is a reason why the IRS is trying to bring resources to this case. It's an extremely sizable case. Not only that, but it involves an arcane tax avoidance strategy. Now, it may be appropriate. It may not be. That's not why we're here. But it is certainly, beyond question, an arcane tax avoidance scheme that most Americans can't take advantage of. Because most small businesses can't go out and hire international tax accounting experts. They can't set up offshore affiliates. They can't design purported cost-sharing arrangements to shift profits overseas, and then have much of their sales, under that cost-sharing arrangement, actually occur in the United States, what Mr. Hoory referred to as a round trip.

It's a transaction that deserves -- the Americas transaction deserves a lot of scrutiny. Because in the United States, as Ms. Eakes mentioned, we have a voluntary tax system. And it only works if people who pay taxes have confidence that folks who may be pushing the envelope, or may be taking advantage of legal loopholes, for that matter, are scrutinized, so that everyone has the sense that the tax system is fair. In fact, one of the transactions that we're looking at was

investigated by a Senate subcommittee. And we have provided a link in our brief to that subcommittee report.

So what I want to just communicate is, the IRS, to do its job, should be looking for every resource that is available to it, and here that includes hiring out expertise that it needed.

THE COURT: Counsel, let me ask you a question.

Do you agree with Ms. Eakes that at one point in time the IRS had come up with a specific number for this audit?

MR. WEAVER: No. That is absolutely not the case.

THE COURT: You would agree with me that if they had, and presented that number, then everything else could very well be for an improper purpose, then?

MR. WEAVER: No. That's not the standard in the Ninth Circuit. So let me explain.

In 2011, the IRS proposed adjustments with a 30-day letter. So that is not a final determination that would preclude the IRS from seeking additional information. The 2014 presentation that Microsoft refers to, that -- as Mr. Hoory states in his declaration, and I think he also said things to the same effect during his testimony, that you could see it here -- was a preliminary set of numbers to trigger a discussion towards resolution. Because by that time, it was pretty clear that Microsoft was using these projections that were way, way different than, for example, if you went out and you looked in their SEC report, in terms of growth rates and so

forth.

So it's very clear from Mr. Hoory's declaration that there never were any final numbers with respect to the Americas transaction. In fact, although we didn't have space to include it in our brief, one of the paragraphs in Mr. Hoory's declaration talks about the spreadsheets that were provided to Microsoft four days before the meeting. And those spreadsheets have a legend on them saying, "This is preliminary." Not only that, but they have confused a method, a methodology -- which I don't want to focus much on today, the discounted cash flow method; it's a means of valuing something -- with a number.

So, yes, the IRS has said: The DCF position is our primary position. And this residual profit split method, that they wanted to look at so they didn't get accused of being arbitrary and capricious, we're looking at that too. But both of those methods changed -- for among other reasons, the Americas transaction involves transfer pricing, payments going offshore to Puerto Rico for supposedly the software -- or the allocable profit that's allocable in the software that was transferred. The transfer pricing had not been scrutinized in terms of utilizing or reformulating assumptions by the first expert, Heimert. He just used what Microsoft had used. So all the numbers were going to change, and Mr. Hoory made that very clear.

So I don't want to overdo it, but, no way. The numbers

were not final anyway. But what I really want to emphasize is, take a look at the Ninth Circuit *Richey* case. That's in our brief, under the part that deals with summonses. And in that case, a taxpayer actually reached a closing agreement with the IRS. "We're done. We agree. We signed on the dotted line." And yet, the IRS, who had issued a summons a few weeks or months before, was able to enforce that summons on the theory that just because -- even if you issue a stat notice, a notice of deficiency, that is not a determination that would preclude you from seeking more information if you feel you still need more information to get to the right number.

And I guess I would wrap this part of my answer up by saying, if you look at the designated summons, and then you go back and you look at Mr. Hoory's Exhibit 1 to his current declaration, which was the declaration submitted earlier, much earlier in the proceeding, and you get to something like Paragraph 34, you're going to see a mantra after almost every single request that he's identifying: We need this information to get to the relative value between things Microsoft transferred offshore, software technology, and things that Microsoft retained.

And that's important, because how you divide these two big things, and then how you weigh them, determines how much money can go offshore. So if the technology is worth a lot, then a lot of money flows offshore. But, on the other hand, if the

name brand and customer relationships are worth a lot, then not so much money flows offshore. And Mr. Hoory has been -- along with the IRS -- has been trying to get at that. And it's a difficult thing to do. And if you have questions, I'll be happy to address those. I can come back to that. But it is a highly complex analysis, and it is in process.

And then finally, let's talk about the APAC, the other transaction here at issue. If you look at Mr. Hoory's declaration, he had conversations with Microsoft, in December 2013, and made clear that they were not in a place to make a presentation even, under that transaction. In fact, there were outstanding IDRs, at that point, that needed to be answered before they would be ready to do anything. And Microsoft has never had a presentation on APAC. So to say that they're done on the APAC transaction, there's just no evidence in the record whatsoever for that.

Let me propose -- if I can operate this PowerPoint -- a framework, Your Honor, for how might be a good way to go about analyzing this case. Because a lot has gotten jumbled up. And after I'm done with this slide, I am going to go to the statute, because Ms. Eakes spent a lot of time on the statute. And it's a legal issue I want to make sure I address.

But in terms of the analysis of how this case should be decided, the summons enforcement case, the first question is, is there a legitimate purpose -- a legitimate purpose -- for

seeking information about APAC? If the answer is yes, we're done. We're done except for potentially, maybe, for how the interviews are conducted in terms of -- from what Ms. Eakes said, Microsoft wouldn't care if Quinn Emanuel did anything other than open its mouth.

Next question, does the IRS have a legitimate purpose -- a legitimate purpose -- for seeking documents regarding the Americas transaction? If the answer is yes, then we're done on that.

THE COURT: Let me clarify something.

MR. WEAVER: Yes.

THE COURT: You're not arguing to me that preparing for litigation is -- would be a legitimate purpose?

MR. WEAVER: Actually, I'm going to make a distinction. Even if -- the case law will show, and I will hit on this. But the Southern District of New York *PAA Management* case, there were actually two district court cases for *PAA Management*, one in the Northern District of Illinois, and another in the Southern District of New York. And the one in the Southern District of New York went up to the Second Circuit. And we cited to both the Southern District of New York and the Second Circuit.

And in that case, the district court judge has pretty much figured out that the IRS was preparing for litigation, because the auditor, as I recall, basically said something to that --

to -- "I'm done." And the summonses had been issued just a few weeks or maybe a few days before the statute of limitations ran. So, I mean, all the inferences were there, that this is to prepare for litigation.

But what the Court figured out -- and the summonses were enforced -- the Court figured out is, the IRS was in a world of hurt. Even though that audit had not been effected very well, and had dragged on, and had been muddled up, actually, I think one of the courts concluded, it was clear that ultimately the IRS had just said: Okay. We're going to write off -- we're going to disallow a hundred percent of whatever it was at issue in that case. It was a partnership case. And the Court figured out: Gee, the IRS is going into court, tax court, having disallowed a hundred percent of something. It hasn't done its job. It doesn't have a supportable case. And so it was perfectly fine, even in that instance, where clearly they were preparing for tax court, to try to fix their audit to try to get to the right number. So as long as you're trying to get to the right number, and you've issued a summons before the tax court proceeding starts, it's permissible.

Now, just to finish up on the analytic framework here -- okay. Now we're talking about interviews. Really, it's the same analysis. But then underneath that, since the IRS has indicated it plans to have Quinn Emanuel participate fully in the interviews, then the question is, does the statute, the

summons statute, 7602, permit 6103(n) contractors -- and just let me emphasize, before I forget this, 6103 is not about examining books and records. 6103 is a confidentiality statute. It's a really long section of code. But the idea behind that section of code is, if you look at taxpayer information, taxpayer return or return information, you can't start disclosing that to folks. You have to keep it confidential. And there's civil and criminal penalties that inure if you don't do that. And IRS attorneys, DOJ attorneys that work on tax cases, we're all bound by these provisions, and so are contractors. But it has nothing to do with documents versus testimony. Whatever. It can be testimony. It can be documents. 6103 says, "Contractor, you have to keep this confidential."

But anyway, to finish with the slide, the next question is, does the statute permit it? And I'm going to argue that if the statute permits what the IRS is proposing to do here, you never need to reach the regulation. The regulation clarifies the statute, and it puts everyone on notice about what the IRS is planning to do in complicated audits. Because remember, as Mr. Hoory testified, this regulation had its genesis in a case that was being managed or associated with another colleague in his office by the name of Tom Ralph. And so, you know, the reg is there to put everyone on notice, and it certainly clarifies what the statute is about.

But Your Honor doesn't even need to reach the reg, not because 7602 prohibits what we're planning to do, or seeking to do, but to the contrary, because 7602 permits it. And that is where I want to turn to next. So I'm going to go to that section of my argument here.

So Section 7602 is an empowering statute. It empowers the IRS to investigate civil and criminal tax matters. It's an expansive information-gathering statute, according to the Supreme Court. It's about scope of authority. It's not about limits. And let me just -- if I can operate this -- pull up the statute for a second.

Now, Microsoft had the statute up. I want to emphasize something slightly different here. The statute is about authority, authority to summons. And the Secretary is authorized. What the Secretary is authorized to do are three things: To examine books and records. That's (a)(1). To summon the person. But then if you keep reading, "to appear." And to do what? Produce books, papers, and records, and to give testimony. And then three is to take testimony, which, you know, I'll show you the Court's Ninth Circuit authority for this in a minute.

Items 1 and 3 can happen outside of the summons process. In fact, part three here is what took place in September and October of 2014. Item 1 can happen either informally, through IDR requests or whatever, or through the summons process in

(a)(2). But I want to emphasize this statute is about authority. And I also want to emphasize that we're not operating in a vacuum here.

I think one of the key cases that we want to refer the Court to is the Supreme Court case of *Euge v. The United States*. And that case talks about a formidable line of precedent construing congressional intent to uphold the enforcement authority of the Service, if such authority is necessary for the effective enforcement of revenue laws and is not undercut by contrary legislative purposes.

Now, *Euge* gives several examples. I want to just talk about a few to illustrate how 7602, the summons statute, is an empowering statute that has been construed broadly to permit the IRS to do what it seeks to do, subject to the limits of law.

In the seminal case of *The United States v. Powell*, the issue there was probable cause and whether the IRS needed to demonstrate probable cause for an audit that was occurring after the normal statute of limitations had run, and was based on a theory of fraud. Did the IRS have to come up with some evidence of fraud? The Supreme Court says, no, you don't have to meet some sort of probable cause standard. Mere suspicion is enough.

Let's move forward. There was -- the statute has been clarified by Congress since. But there was some concern about

whether or not the summons authority would authorize criminal investigations. And it could have gone either way, but the Supreme Court read the statute expansively in *Donaldson* and later in *LaSalle*.

In the case of *Bisceglia*, there was a question about whether the IRS could do something called a John Doe summons, which is, there's no particular individual named, but -- you know, let's say you've summoned information from a bank. And again, the Supreme Court construed the statute broadly.

And finally, *Euge* itself was about handwriting exemplars. You'll not find anything in 7602(a)(1), (2), or (3) about producing handwriting exemplars, but the statute was construed broadly.

The principle here -- back to *Euge* -- is that if the summons is necessary for the effective performance of the IRS's responsibilities, "That authority should be upheld absent express statutory prohibition or substantial countervailing policies." Well, let's talk about that for a minute. Where is the express statutory prohibition? There is none. We're going to look at 7602(a) closely. But that statute, unlike what Ms. Eakes says, doesn't say "only the Secretary." It says, "The Secretary is authorized." It does not speak to whether certain aspects of those tasks can be farmed out or contracted out. In fact, Microsoft, I don't believe, has a problem with farming out (a)(1), examining books and records. So there is

no statutory prohibition to preclude the IRS from farming out certain aspects of its summons process. There is one that we will talk about in a minute, but Microsoft does not identify any.

Now, I also want to -- and that's -- let me move on.

I also want to talk about the history of this statute. The summons statutes -- and this is from the *LaSalle* case -- have their genesis back in the Civil War era. And for a long time, there were separate summons statutes for assessment versus collection. And then in the 1954 code, we basically have what we have now in 7602(a), with minor tweaks. And it essentially consolidated Sections 3614, which was an assessment statute, and then collections statutes, 3615 and 3654. And the legislative history, to the extent there is, as recounted by *LaSalle*, purported not to make any substantive changes.

But let me point this out, Your Honor. If you look at 3615, the predecessor statute, it has in that statute a subsection for how you're going to serve the summons and another subsection about how you're going to enforce the summons. Those sections got split out of the old statute and are now in different sections, 7603 and 7604, in the current statutory regime. So basically, what I'm saying is, there is no procedural aspect anymore to 7602. It's an empowering, authorizing statute.

Moreover, because there were previously two collections

statutes that talked about -- as does the current statute, talks about, if you look at the title here, "Examination of Books and Witnesses" -- there is no way that under (a)(1), when it talks about examining books and papers, that is not a reference to a general audit. Because the same -- not the same language, but the same title or similar title appears in the collections statutes. What examining books and records and papers means is exactly what it says, inspecting books and records and papers. So when they argue that somehow (a)(1) has a different meaning, that doesn't comport with the statutory history.

Finally, let me go back to my PowerPoint here.

We have cited to a Tenth Circuit case that specifically says that the 7602 statute does not establish procedures by which the authority granted to the IRS may be exercised. There are many other statutes in the code that do talk about procedures. 7603 is service. 7609, third party summonses. 7611, audits of churches. There's special restrictions on that. 7612, computer software. 7521, reporting taxpayer interviews. 7602 is not about procedure.

Now, Microsoft pointed out in its brief that, "Oh, wait a minute. *Neece* goes on to talk about the summons power being fettered." Well, what it's being fettered there by is a right to financial privacy. Because in that particular case, the IRS was -- I think it was seeking information from a bank. There

are limits. But the point is, as far as procedure goes, they've not pointed out a statute that limits the scope of 7602.

Now, there is a Ninth Circuit case that I don't believe was cited by anyone -- so we apologize for that -- that does address 7602. It's called *Speck vs. U.S.* I'm going to refer to it for a second, but I brought along copies. So let me just hand counsel a copy.

And may I approach?

THE COURT: You may.

MR. WEAVER: So the *Speck* case is a Ninth Circuit case. And what the case was about is, there was an investigation by the IRS into possible tax evasion by a taxicab company. And the IRS sent out circular letters. And so that was challenged. And the claim was that 7602 dictated how the IRS could get its information.

And if you read through the opinion, the Ninth Circuit concludes, no, that's not right. Under the better interpretation -- I'm reading from my slide now -- Section 7602 provides three separate means of such inquiry; the first one, an informal, non-compulsory means of inquiry; and then two is a summons; and three, they provide mechanisms for formal compulsion.

And going back to the statute, you can again see that under two, two covers both one and three, in terms of producing

things at a summons. There really is no principled reason to distinguish the way you're going to treat one from three. And we'll talk about that more in a minute.

Now, Microsoft is fine with Quinn Emanuel examining books and records. But there really is no reason to distinguish between one and three unless there's some other problem. Microsoft has concerns that somehow discretion is being exercised under three. That's not necessarily the case. But I would posit that if Your Honor makes a ruling that contractors can't perform the function under (a)(3), the next thing that we'll see in the courts will be arguments that contractors can't perform (a)(1) either. These are co-equal prongs of the statute, as the Ninth Circuit opined.

And I've already addressed, I think, earlier, why 6103(n), the confidentiality statute, doesn't just cover one. It covers three as well. It protects taxpayers from disclosure -- unauthorized disclosure of information, whether that information comes in through testimony, or whether it comes in through books and records.

Now, what about the argument that 7602(a)(2) and (a)(3) are redundant? Again, that's really contrary to *Speck*, and it's also contrary to the plain language of the statute. Because, again, (a)(3) and (a)(1) have a wider scope than does (a)(2).

Now, let me talk for a moment about taking testimony. I

want to put that into the context of inherently governmental functions. Taking testimony certainly does involve asking questions. You will get no debate from us on that. It certainly involves that. It also involves selecting individuals, selecting topics, placing someone under oath, deciding whether something has gone beyond the boundaries of the scope of the interview.

And let me refer the Court, just for an example, to Federal Rule of Civil Procedure 28, which is about persons before whom depositions -- now, this is civil procedure. It's not audit procedure. But there, in a rule of civil procedure that we deal with, you know, in litigation here, (a)(1)(b) talks about, "A person appointed by the Court where the action is pending to administer oaths and take testimony." So it is not so clear, to the extent to which there are varying activities or subcomponents of taking testimony.

So let's talk about, are there limits here? Are there limits on what the IRS can subcontract out? And, yes, there are. And the limit is the FAIR Act, because it is impermissible for governmental agencies to contract for the performance of inherently governmental functions. And, in fact, there's a statute, the FAIR Act, that defines what inherently governmental function is, and goes on to indicate that that function does not normally include gathering information, or providing advice, opinions, recommendations, or

ideas to federal government officials.

Now, that is the statute. The executive branch has taken that statute -- and I want to spend a little time on this, because I think it's really important. I think it was in 2011, the Office of Management and Budget published this OMB policy letter to define, essentially, what it meant, what "inherently governmental" meant, and what an inherently governmental function was. And this wasn't just something they voluntarily did. If you look in the middle column here, this was done at the direction of the President, and it was also done in accordance with an act, Duncan Hunter Act, to create a single definition for the term "inherently governmental function" that might address deficiencies in what was occurring at the time.

And so that's what this letter ended up doing. And the approach that was taken is to define "inherently governmental" for the executive branch to build on and use the FAIR Act. So that's what happened. And let me just go down to the last highlighted bit here. The definition provided by the policy letter replaces existing definitions, even some of the acquisition regulations.

So one of the things that was attached to Microsoft's brief was some sort of JAG court letter talking about what could be performed by attorneys that were not government attorneys. That's superseded to the degree that it's even authenticated. I'm not sure -- from Mr. Rosen's declaration,

I'm not even sure where it came from. But this letter is what you look to for the executive branch's interpretation about what it means to be doing an inherently governmental function.

And sure enough, if we turn to Page 10, here's a definition. It tracks along with the statute, "So intimately related to a public interest as to require performance by federal government employees." That's pretty broad. It excludes gathering information or providing advice, opinions, or recommendations. So it tracks with the FAIR Act.

Now, let me go back, before we get to the letter itself. There's analysis that goes with this. And I would encourage the Court to take a look at that analysis in the table. Because what this does is illustrate how one can break a function down between things that really are inherently government, and cannot be performed by non-government employees, and things that can be. For example, human resources management, that's an inherently governmental function. And selecting who you're going to hire in the federal workforce, that's inherently governmental. But support is not.

Now, let me scroll down to help clarify these definitions. OMB came up with a couple of guidelines to help illustrate when something was inherently governmental. And this is really important. I think this -- if there's one thing that I would ask Your Honor to consider, it's this set of guidelines here.

Because there are two tests. One is the nature of the function. And the other, that Microsoft has talked a lot about, is exercise of discretion.

So let's first look at the nature of the function. Examples that are inherently governmental include officially representing the United States in an intergovernmental forum or body. That might be like appearing and representing the United States in court, or something like that. Quinn Emanuel is not tasked with doing that. The contract does not permit it to do that. So the contract, and the relationship that Quinn Emanuel has under the contract, does not violate the nature of the function test.

But what I really want to refer to now is the exercise of discretion test. Because it isn't just exercise of discretion, like picking "A" or "B," apples or oranges. It's more specific than that. If the exercise of discretion commits the government to a course of action where two or more alternative courses of action exist, and decision-making is not already limited or guided by existing policies, procedures, et cetera. So it's not just that somebody can decide to ask this question or that question, or follow up on this line of questioning or that questioning. What's an improper exercise of discretion by a nongovernment employee is something that's committing the government to a course of action.

And if we go on down here, it even further illustrates

this. It talks about meaningful oversight. And then it talks about a function may be appropriately performed by a contractor consistent with the restrictions in the section, including those involving the exercise of discretion that has the potential for influencing the authority, accountability, and responsibilities of government officials where the contractor does not have the authority to decide the overall course of action, but is tasked to develop options, et cetera.

So "exercise of discretion" has a meaning in this context, and it's committing the government to an overall course of action. That would be like making an audit determination, or deciding a theory to pursue. It doesn't mean trying to figure out what questions to ask in an interview.

Now, in addition to this, there is an Appendix A and B that are attached to this to help further illustrate. Let me go to Page 14. Page 14 starts a list of things that are inherently governmental. There's Appendix A, examples of inherently governmental functions. So let's take a look at some of this.

"Direct conduct of a criminal investigation." Okay. That makes sense, and that's not what Quinn Emanuel is doing here. "Control of prosecutions or adjudicatory functions." Again, that makes sense, that's inherently governmental. "The direction and control of federal employees." Again, Quinn Emanuel is not directing or controlling anyone. And, in fact,

you could probably observe, from listening to Mr. Hoory for several hours, it would be unlikely that Quinn Emanuel would be directing or controlling Mr. Hoory.

And then two more -- because Ms. Eakes brought it up -- what else is inherently governmental? "Collection, control, and disbursement of various things, including taxes, unless otherwise authorized." That's inherently governmental. And, in fact, if you look in our administrative record that we submitted to the Court, there's a whole section in that administrative record that addresses what developed when Congress made it an express exception to allow contractors to do limited things in that circumstance in terms of private debt collection. But the point is, the whole function is inherently governmental.

And then finally, maybe a key note here, "Representation of government before administrative and judicial tribunals." And this is important, Your Honor. Hopefully, I'll get to it. But in the contract with Quinn Emanuel, there is a subsection in that contract that says, "Your authority is limited. You can't do inherently governmental things. See this document." And so, has Quinn Emanuel represented the government before an administrative tribunal? Absolutely not.

And with respect to John Gordon, Your Honor, let me just make a couple of points. First, there is absolutely no way Microsoft was fooled into thinking that John Gordon represented

the United States in a formal way, because they had negotiated his limited involvement in the interviews in September and October. I tried to admit into evidence -- and Microsoft objected, and its objection was sustained -- to put into evidence a full transcript, subject to redactions, so that Your Honor could get a flavor for what was really going on in those interviews. There's no way to read through those interviews and conclude that John Gordon was exercising discretion or running the interview. He typically, in these interviews, has a few things to ask somewhere in the middle or the end of the interviews. Now, going forward, that would not necessarily be the case. But to say that John Gordon for the IRS somehow shows evidence that he's performing an inherently governmental function is just not accurate.

Now, let's take a look at functions that are closely associated but not inherently governmental, that may need supervision but are not inherently governmental. And I just want to point out two. One, services in support of inherently governmental functions. And then Number 8, provision of legal advice and interpretations of regulations and statutes to government officials.

Bottom line from this to take away is that the one thing that does, in fact, limit contracting authority to contract out segments of either examination of books and records, or taking testimony, is, in fact, whether the function being performed

isn't inherently governmental. The statute itself does not expressly say anything about what can be contracted out for.

And I'm about to turn to Microsoft's argument that somehow we've delegated out authority to Quinn Emanuel. Quite to the contrary. That's exactly what the IRS did not do. It did not delegate its authority out. It's contracted to have a contractor perform non-inherently governmental functions. Specifically in the contract, that's what's contemplated.

Now, Microsoft cites to a number of cases for the proposition that the IRS has improperly delegated taking testimony to Quinn Emanuel. To the extent that asking questions were inherently governmental -- and clearly it's not -- there would be a problem. But asking questions is not inherently governmental under this test. So if there is an inherently governmental function to taking testimony, which would be putting somebody under oath, or figuring out who's going to come in to testify, yes, that is not something that is being contracted out. There is no delegation to Quinn Emanuel. So the cases that are cited in that regard are simply inapposite.

Now, let me just mention a couple, the *Halverson vs. Slater* case. It's a D.C. Circuit case. That involves delegation of authority that included -- if I read the case right -- investigation and prosecution of violations, auditing, and rate-making. So there's a case that really did involve

inherently governmental functions.

The *U.S. vs. Giordano* case, that case involved, if I recall correctly, somebody in the DOJ, an executive assistant, signing a wire tap authorization on behalf of an assistant attorney general. It's inapposite. And again, it's a delegation case, and we're not talking about delegation in this context.

And finally, much focus was placed on *United States Telecom vs. FCC*. And I would just refer Your Honor to that case. Because if you read through that case, part of it says, "Second, there is some authority for the view that a federal agency may use an outside entity, such as a state agency or private contractor, to provide the agency with factual information." And then it goes on and talks about another case, a Ninth Circuit case called *Assiniboine Sioux Tribes vs. Board of Oil and Gas*. And, in fact, there are cases cited in *U.S. Telecom*. There's a case that upheld a federal certifying agency's decision to hire a private contractor to conduct surveys of residential treatment centers, et cetera, et cetera, et cetera. So it is not a clear-cut case. If you're gathering information, and you're not doing something inherently governmental, then there is no bar for contracting it out, as the United States has done here. By the way, the *Assiniboine* case -- I think it was in a motion to dismiss procedure -- but the allegation there was that the agency was not providing any

meaningful review and was being a rubber stamp.

So when I get to the regulation, I'm going to talk about this. But the regulation specifically has thought about, carefully thought about, how to make sure that a contractor does not veer into performing inherently governmental functions. There has to be an IRS person there supervising or providing guidance to what's going on.

Now, just to wrap up the statute part of my argument, if asking questions in an interview is permitted by the statute, if there's nothing that limits the IRS from doing it -- and no one's identified a statute that says you can't do it -- then there's no abuse of process. And this is not a case where Your Honor needs to go into the fine points of regulatory administrative law. Because if there's no abuse of process, then the summonses should be enforced.

And it may not be super clear. It may be debatable. But the way 7602 has been construed by the courts is, if there is a legitimate purpose here -- and there is, and I'll talk about that. But essentially, you have contractors. It's evolved over the years. First, the audits got more complex, and they needed folks to come in and look at books and records. And in transfer pricing audits, they were having some of the experts ask questions, and then somebody objected. So this has evolved over time. But there's a real purpose and a real benefit to having somebody actually ask the question, instead of take five

minutes to write the questions out on a notepad.

And in terms of whether there's an improper exercise of discretion by asking the questions, my recollection is that whenever Quinn Emanuel got into an area that Microsoft's counsel didn't like in these September/October interviews, they made a big deal about it. And I recall one example, I believe, where Mr. Hoory essentially took over, jumped in, and defused the situation. So even in that informal setting, there was control over what Quinn Emanuel was doing. So in short, if permitted by statute, there's no abuse of process.

Now, let me touch on the regulation, because Microsoft has identified two different attacks or two reasons why the regulation is improper. The first one has to do with procedure. They complained that this regulation did not go through the APA's notice and comment procedure. And, in fact, of course, it did not, because it was a temporary regulation.

So what was the status of temporary regulations in the late '80s? Well, I have the legislative history here, and I'm going to pull it up. We cited to this in our brief. I think Mr. Rosen's declaration attaches the Senate report. In addition here, what we have is the conference committee report, because that explains a little bit more. But I believe we have hard copies. And again, with Your Honor's permission, I'll just hand up a copy.

THE COURT: You may.

MR. WEAVER: So Your Honor, what I want to refer you to is the fifth page of this document. I'm going to try to blow it up a little bit. Not very good at this.

But the present law -- there was an amendment to a statute, in 1988, that gave us the current regime that governs temporary regulations. Prior to 1988, the IRS would issue temporary regulations, and there was no time limit on how long those temporary regulations might last. But if you read the present course of the law, this -- Congress was aware of this. "Generally, temporary regulations are effective immediately upon publication, and remain in effect until replaced by final regulations." That's where things were when what Microsoft has referred to, and we've referred to, 7805(e), was added to the statute.

And I want to now go to the Senate amendment and refer Your Honor to a couple of things in the Senate amendment part of this, on Page 218 of this Senate report. "The IRS may continue its present practice of issuing proposed regulations by cross reference at the time temporary regulations are issued." And then it goes on at the end to say, "The expiration of temporary regulations at the end of the two-year period is not to affect the validity of those regulations during the two-year period."

Now, think about that for a minute. The Congress is specifically contemplating putting a time limit on temporary

regulations, and they're going to require -- and what the statute requires now -- is that when you issue a temporary regulation, you also have to issue a proposed regulation at the same time that is subject to notice and comment. But during the intervening period, before there's a final regulation -- it can go on as long as a couple years, that later became three years in the conference report, if you look in the middle of the page there. Two years got changed to three years.

But the point being, during that time, the temporary regulation is valid. Now, how could that be, if temporary regulations are subject to notice and comment? If they were subject to notice and comment, then they wouldn't be valid, because proposed regulations that are subject to notice and comment, under the APA, don't have validity until the notice and comment period is over and they're turned into final regulations.

So the point being, Congress clearly intended that temporary regulations could exist for a limited time period under the statutory change, the statutory regime that was in place and about to be changed by the addition of 7805(e). They knew what the temporary regs were. They created a structure that adopted, clearly adopted, IRS practice. If Congress thought the APA applied, then the temporary regulation would not be valid. So it's just directly contradictory to the idea -- to say that temporary regulations are subject to notice

and comment is directly contradictory to the clear stated intent of this legislative history.

Now, let's take a look at the statute itself. Here's the statute. I'll scroll down to part (e), which was added. Here is the express language of the actual statute. "Any temporary regulation issued by the Secretary shall also be issued as a proposed regulation." And then there's a three-year duration for that temporary regulation. Well, what's a proposed regulation? Well, that's what the APA addresses in Section 553(b), general notice of proposed rule-making. Let's go back to 7805. There's proposed regulation.

But a temporary regulation is something different. This scheme, similar to the *Asiana Airlines* case that we cite to in our brief, does not comport with the APA. And the Court should not determine that the Congress must have been wrong. The congressional intent is very clear here. The statute is clear. This is a structure that is very specific. And not only that, if Congress wanted to have notice and comment for a temporary regulation, it certainly knew how to do it. In fact, at the same time that (e) was implemented, another section was implemented, in 1988, requiring certain impact on small businesses be evaluated. And so the regulation had to be submitted to the Chief Counsel for Advocacy for Small Business Administration for comment. So, yes, even temporary regulations had to be -- had to go through the SBA process, but

Congress chose not to require temporary regulations to go through the APA notice and comment process.

Moreover, I believe, in 1996, Congress changed retroactivity provisions. Part B, I believe there was a change -- hope I'm right about that -- in 1996. They could have changed the law then and chose not to. So temporary regulations have been issued by the IRS over a period of decades, and Congress has never changed the law.

Now, Microsoft counters that, well, you have to have good cause. And, in fact, if you look at 553, there are exceptions -- 559, I think -- exceptions to notice and comment. One of them is the good cause exception. But there's nothing in the legislative history, and there's nothing in the statute that says you have to show good cause to issue a temporary regulation. So I would posit it's not the place of the court to write that into the law. In *Asiana Airlines*, a court concluded that specific procedures differed from those of the APA and couldn't be reconciled with the statute. And a plain reading here yields the same result. And where possible, there's a statute -- a principle of statutory construction, a court should attempt to harmonize conflicting statutes.

Now, the only logical conclusion to draw from Microsoft's argument is that all temporary regulations must be invalid, because, by definition, they don't have notice and comment. Some have good cause exceptions. Some don't. But there's no

reason to create that kind of disruption in decades-old practice without clear authority to the contrary.

And what is Microsoft's authority? Microsoft's authority is a concurring opinion in a tax court case, a concurring opinion that didn't need to reach the issue of 7805, but chose to. But it was two judges out of a whole host of tax court judges. It's not binding authority, either on account of being a tax court case, and it's not even the holding of a tax court case. It's a concurring opinion. It is not precedent.

If you look to the Ninth Circuit case law -- and we've cited these in our brief -- there are a number of cases, in the Ninth Circuit and elsewhere, where temporary regulations have been upheld. Now, I will fully point out that the issue we're presenting here, whether 7805 is an exception to the APA, that issue was not present in those cases. But the point is, it was a temporary regulation, and it was upheld. So I would say, given where the landscape of the law is, there's no reason in a summons proceeding to suddenly overturn decades of practice of the IRS, and conclude that a statute doesn't mean what it clearly means.

The other authority cited by Microsoft is a case, a Fifth Circuit case called *Burks*. And there, there's an ambiguous footnote -- I think it's Footnote 9 -- that refers to this idea. And I think it refers to the idea in the context of a law review article.

Finally, let me just quickly mention the *Dickinson vs. Zurko* case. That case is cited for the proposition that there has to be an express override of the APA. And, in fact, the APA statute says, if you're going to do something different, you need to make it express. And I would argue this statute is express. There's no other way to interpret it, this statute being 7805.

But what is *Dickinson* about? It's about a standard of review in Court of Federal Claims cases. And the conclusion there was that the standard in judicial review wasn't so clear. There wasn't any kind of well-established exception to the APA. So those cases really are inapposite. And what Microsoft is asking you to do, Your Honor, is to go way out on a limb and interpret 7805 in a way that there's no authority for that.

Okay. Let me quickly turn to the other exception. There's another reason why you don't have to do notice and comment. And that is, you don't have to do notice and comment if a regulation is interpretive. And I'll refer Your Honor to the Ninth Circuit case of *Hemp*, we cited in our brief, where, "In general terms" -- I'm quoting -- "interpretive rules merely explain, but do not add to, the substantive law that already exists in the form of a statute or legislative rule," citing to another Ninth Circuit case. Then they apply a test, a three-part test, three-prong test, to try to figure out what's legislative and interpretive. And they freely acknowledge, I

think, in that case -- and I think many courts acknowledge -- that the interpretive versus legislative distinction is a muddle. It's not easily teased out. But the test that's employed in the Ninth Circuit, from the D.C. Circuit, is the part that we are interested in, "when in the absence of the rule there would not be an adequate legislative basis for enforcement action." Well, here, the enforcement action would not occur under the regulation. It would occur under the summons statute. So this regulation is interpretive, and it's another reason why the lack of notice and comment here is not fatal to the rule.

We argue that the reg is entitled to deference, under *Chevron*, and the *Chevron* standard is twofold. Does the reg directly contradict the statute? For the reasons I've already articulated, no. The statute is actually silent on the issue. Well, then, the second step in the *Chevron* analysis, is the construction of the statute and the reg permissible? Is it permissible? Is there a reasoned -- a reason behind doing it? Doesn't have to be the only reason, or the reason you would choose, but is it permissible? And the *Chevron* standard applies to Treasury regs. That was established by the Supreme Court in the *Mayo* case.

And *Mayo* cites to another case called *Mead*. And the *Mead* case, also a Supreme Court case, clearly makes clear that even when there's no notice and comment, *Chevron* deference may be

afforded an agency decision. And the reference is to the *NationsBank* case. And I would encourage the Court to read *NationsBank vs. North Carolina* -- or *vs. Variable Annuity Life*, 513 U.S. 251, and *Mead*, because those cases are on point here when it comes to *Chevron* deference.

Now, Microsoft has argued that *State Farm* arbitrary and capricious standards should apply. And what I would simply say is, even applying that standard, the regulations still should be upheld, if you get to the point of evaluating the regulation.

Let me just quickly turn to the regulation very quickly.

The regulation has a reasoned analysis as to what -- why it's doing what it does. I've highlighted in green the preamble to the regulation. It talks about taking testimony by asking questions, as Ms. Eakes said. Asking questions is not inherently governmental. And then it analyzes how there will be some sort of safeguard so that inherently governmental functions are not performed by a contractor, under this temporary reg. So the reg itself does address the only limit that is out there on what can happen under 7602.

And then let me just turn to the reg itself, because the reg is even clearer. Yes, there's stray references to taking testimony throughout the administrative record, because "taking testimony" can mean a number of things. But in the reg itself there are four functions that comprise participating fully in

an interview under the guidance of an IRS officer or employee. And those are receipt review of summons, books, and records. No debate about that. Being present during the summons interview. No debate about that. Questioning the person providing the testimony under oath. Questioning the person providing the testimony under oath. That's the language in the reg. That's permitted. It's not inherently governmental. And then asking the summoned person's representative to clarify an objection. This regulation is designed to clarify for taxpayers what's permitted under 7602.

There are other parts of the administrative record that I would refer Your Honor to, to show that the IRS spent a lot of time considering this regulation. It wasn't rushed through. The reg project, I believe, was opened in the first half of 2013. The OMB policy letter that I took the Court through is identified in Part 2 of the administrative record, Pages 1 through 29.

There are statistics. In Part 1, Page 120 through 120(d), there are statistics. The IRS figured out, there's a lot of these large transfer pricing audits, and there's discussion about the reg in this context. The reasoning and justification for why the reg is needed, to promote efficient tax administration and to make use -- efficient use of contractors, is addressed on Page 99 of the administrative record. Other statutes are looked at to compare, on Part 1, Pages 128 through

134.

And I think I'm giving you PDF pages, Your Honor. So once we get past Page 120, the actual page is three pages less. So I'm giving you, I guess, a range. And my apologies for that, because I was -- if I had more time, I'd be putting the PDFs on screen, but I don't have time.

I guess the last thing I would say is that even if Your Honor didn't afford the regulation either *State Farm* or *Chevron* deference, it would still be entitled to an analysis under the *Skidmore* case, and some deference, if you agreed that the regulation was permissible and served a useful purpose.

For my -- the remainder of my time, let me go back and address improper purpose and hit some highlights, if I can.

I would refer Your Honor to the *Sterling Trading* case that we've cited in our brief. It's similar factually, in a way, to the Microsoft audit here. *Sterling* claimed that summonses had issued to obtain documents in advance of litigation and to circumvent more restrictive discovery rules that it would face in tax court.

And you can -- when you look at the case, *Sterling* looks at the timing of the summons as a general principle to try to figure out if something has been sought in advance improperly, in advance of litigation. And the rule is that if the summons is issued before commencement of judicial proceeding, then the summons is generally found to -- not to undermine the discovery

process in tax court.

THE COURT: In the absence of direct evidence to the contrary.

MR. WEAVER: In the absence of direct evidence that everything is done, and that there is no legitimate purpose. In fact, there is language in *Sterling* that talks about it's not the only purpose, or something to that effect. So it stands for the proposition that a purpose is enough.

I think I discussed earlier, Your Honor, the Southern District of New York *PAA Management* case. It stands for the proposition, "Even preparing for tax court is legitimate if the preparation is to formulate a supportable position." I would also refer Your Honor to the *Wooden Horse* case, where an agent, the Court pretty much concluded, issued a summons in retaliation for refusal to extend limitations. But there also was a legitimate purpose, and the summons was enforced.

All right. Let me just recap very briefly for Your Honor. Are we legitimately seeking information here? Mr. Hoory, if you read the transcript from the evidentiary hearing, Pages 176 through -85, that alone is enough. The IRS asked, in 2008, for supporting information for financial projections. They asked again in 2013 and didn't get any further with respect to backup for the projection. They interview somebody in the fall of 2014 who says, "Oh, I was never asked for this stuff." And then, eventually through the summons, they start coming up with

information that showed that there's projections for an abysmal zero percent growth case. I believe zero percent growth -- revenue growth is what was assumed in the APAC model Microsoft used. There's a conservative case. Then there's the regular case that are market expectations. That's not what Microsoft used here. Of course the IRS wants to get this information. And the IRS also needs information as to how to allocate profit between competing and tangible assets.

And again, if you look at the designated summonses, that's what most of those requests are about. And again, during the interviews, the IRS had been told that a program called Business Investment Funds was short term, or that the measure for including something in the basket for being an intangible asset was whether it lasted more than one year. It turned out during the interviews that this program lasted three years, or had an expected life of three years. So there are reasons -- all you need to do is go back and read the transcript -- why this information is being sought.

And when you think about it, when you're trying to figure out what's more important, is it software, or is it the name brand and the customer relationships? Or what am I going to allocate resources to, going forward? Who's making those decisions? The obvious answer is executives. And I think some of what they found out in the interviews is, lower-level people are always going to be looking to the executives to try to

figure out, how did they look in 2005, 2004, 2006? What were they looking at, and where were they going to expend resources? And we're dealing with projections here. So there are plenty of legitimate reasons why this information is needed.

What about allegations that the determination has already been made? I think I've addressed that.

I want to make sure there is one correction in the record. In Paragraph 32 of Mr. Hoory's declaration, he referred to requesting 32 interviews in the fall. Twenty-one occurred out of 23. There were 32 requests, thirty of Microsoft employees and two of KPMG. But the numbers should have been 23 out of 25. The mistake came out of a spreadsheet that I think Microsoft circulated that had an error in a formula. So you go down one, two, three, four, five, six, seven, and all of a sudden it starts over again. But we can correct that declaration, if need be. It's 23 out of 25. Otherwise, the declaration is correct. And I believe Mr. Rosen's declaration, which talks about requests for 29 interviews, is also incorrect. If you look at the Bernard Exhibit 3, Hoory August 28 letter, there's 29 requests. But then there's Bernard Declaration Exhibit 5 that added an additional 30th name, September 9. Now, I think Mr. Rosen did say requested in August, so technically that's correct. But there were 30 interviews requested. I want to make sure that's in the record.

I also want to briefly address the arguments that Microsoft made in its reply. What about this duty to disclose the existence of Quinn Emanuel before there's even a contract? The *Deak-Perera* case is not even close to being authority for Microsoft's claim that the IRS had some sort of duty to disclose somebody it might hire. *Deak-Perera* was about somebody essentially misleading a financial institution. The IRS was supervising a financial institution, and under that guise gathered information that was then used to start going after taxpayers. It was a ruse, I think the Court called it. That's not what happened here.

As a matter of fact, when you think about it, since Quinn Emanuel hadn't even been hired yet, it would be deliberative. It would be something you shouldn't be disclosing at that point in time to somebody, because it was in the decisional -- pre-decisional stage.

I think Ms. Eakes referred to Mr. Hoory's later correspondence and not turning over a full contract. There was no need to. What he referred to in the scope of work, that set out Quinn Emanuel's responsibilities. So I just want to make sure I hit that.

Moreover, when Microsoft signed the statute of limitations extension, Microsoft, what did they know? They knew that Mr. Hoory wanted to do formal interviews, whether things are resolved or not. That's in Mr. Hoory's declaration. As part

of this call where Mr. Sample initially says we're not going to pursue resolution on February 17, the IRS makes clear, okay, it's going to go gather facts. That's in Mr. Hoory's declaration.

The preceding year, in 2013, there had been discussions about designating the case for litigation. And the IRS said, "There's no decision made in that regard." In fact, Mr. Hoory and Mr. Maruca didn't have the authority to do that, as I think Microsoft just pointed out. What they didn't point out, in the designation for litigation IRM that they attached, is, if you look in there, there's a duty to actually fully prepare a case. If it's going to be designated for litigation, it better be fully, factually developed. So there is, again, nothing wrong with factually developing your case in the exam phase, especially if it might be designated for litigation.

Microsoft accuses the IRS of conducting pretrial discovery on behalf of Quinn Emanuel. Well, if you look at the actual contract -- and I don't think I have time to pull it up -- just, actually, if you read the contract, there are two phases -- or one phase with two parts to that contract. And that's it. Now, so when Microsoft refers to a 2013 e-mail referring to five potential phases with Boies Schiller, that never occurred. Moreover, Mr. Hoory's testimony during the hearing was consistent with that. Although he wasn't examined -- cross examined at length on this, look to Page 144

of the transcript in that regard, and look to Mr. Hoory's declaration submitted this time around, Paragraph 43, where ultimately the IRS decided that there would just be a contract for exam.

The other thing I want to make sure that I address are some of the exhibits that Microsoft has submitted. Rosen Reply Exhibit 3 is a matter assessment and conflict waiver agreement. They're drawing inferences about the purpose of hiring Quinn Emanuel from that document. It's an unsigned document. It was produced in the FOIA litigation. It was never executed, because the IRS didn't want to sign it. So it means nothing.

Rosen Reply Exhibit 4, what was referred to was a stray anticipation of litigation phrase in that contract. But what Microsoft didn't show you were other places in this contract that put it in context. So if we go to -- I think it's Page 7. If you go back and look, Your Honor, at Page 7 and Page 8, justifying this contract, there's a narrative. Actually, I guess it's Page -- PDF Page 6 and 7 of the Bates Number ending 1658 and 1659. You'll see that Mr. Hoory's justification for this contract, what's going to happen, is exactly -- pretty much exactly what he testified to during the hearing. And the gist of it is, given the size of this multi-billion case, it's critical that they get some consistency and tie all the moving parts together. And they thought, as is their right, as the agency has the discretion to do this, it would be a good idea

to get somebody very experienced in doing just that to assist the IRS in this very large audit. There's no improper purpose here.

There's some inference drawn that somehow Chief Counsel is involved; therefore, it must be litigation. I believe it's the next page. Chief Counsel actually has to sign off on all expert contracts over $75,000. So the fact that Chief Counsel is involved here doesn't mean a whole lot.

Then let me just also go to one more page in this contract -- or this set of documents -- and that is this funding request portion of the contract. What does it say at the bottom? Unfunded portion of the request. None for LB&I exam. That's the contract that did end up getting executed. Post LB&I jurisdictional phases, if any -- if any -- would be the subject of a separate counsel jurisdiction contract. That's not what we're here about. We're here about an exam contract. So, sure, is there the thought that we might use these guys if this goes to litigation? Absolutely. There's nothing wrong with that. In fact, you would do that with other experts as well.

What about the idea that Quinn Emanuel is somehow improperly conducting the audit? Well, remember, the test here is whether there is one proper purpose for this audit request. So how the IRS is getting its information is really not the subject of this proceeding. And what Ms. Eakes didn't show

you, when she showed you a part of the contract where they're doing various things, like gathering information or making recommendations, it's preceded on PDF Page 10 of this contract. It always is the contractor's assistance. Assistance. It's assistance. It's not Quinn Emanuel doing the audit. It's Quinn Emanuel assisting the IRS and making recommendations.

And in terms of case evaluation, they pulled language out of the case evaluation section and suggest that somehow the IRS is obligated to go running and find things for Quinn Emanuel. No. That's -- if Quinn Emanuel asks for something that would help them evaluate the case, okay. The contract says the IRS will try to go get it. That doesn't mean that Quinn Emanuel is running the audit. And a common sense reading of that makes clear that the purpose of that evaluation was to try to figure out and give, essentially, the IRS a sounding board, to see, you know, if -- how their case was developed. So the actual language of the contract does not support the inferences that Microsoft draws.

I also want to address this argument that somehow or other by statute the IRS cannot use anyone other than IRS Chief Counsel for anything. That is not correct. The statute doesn't say that. It doesn't say "exclusively." It says that Chief Counsel is the adviser.

But let's think about that for a second. DOJ advises the IRS from time to time. What does the IRS do if there's a

question of, like, Swiss bank law, or, you know, some foreign law that really the IRS doesn't have any expertise on? What about some state matter, state law matter? There's nothing preventing the IRS from obtaining advice in that regard. And there are actual contracting statutes. We cite to one in a footnote in our brief. I believe it's 5 U.S.C. 3109. And if you were to go into Westlaw and look at notes of decision, under 3109, you'll see things like some Office of Legal Counsel opinion where Ropes & Gray was hired in 1984 to do some legal work. There's a case called *Boyle*, out of the Court of Federal Claims, in the early 1960s. There is statutory authority for the IRS to manage its budget and to hire contractors as it sees fit. And this statute that they referred to doesn't address that.

I think also Ms. Eakes referred to Section 6110 as requiring that IRS advice be made public. That's certainly not the case. Certain advice is made public. But there would be no attorney-client privilege were all IRS counsel advice made public. That's just not the case.

Then let me also, Your Honor, actually go to the Quinn Emanuel contract, very quickly. And I just want to make sure I hit this before I end.

In this contract, there is an express -- express -- limitation on what Quinn Emanuel can do. The contractor shall not have the authority to perform inherently governmental

functions, as described in the OFPP policy letter that we looked at in detail. That's in the contract. And so the IRS has put into this contract the safeguards that the regulation actually considers, to make sure that Quinn Emanuel is cabin to doing what it's permitted to do. Now, it is a law firm. But like any other contractor, it is required to keep taxpayer information confidential, and safeguards were put into place in that regard under 6103(n). Nondisclosure agreements were signed.

So the bottom line is, Your Honor, Microsoft has a heavy burden to make a case why the IRS lacks an improper purpose. And they haven't carried that burden. What they've given you, Your Honor, is a lot of speculation, but no hard evidence.

Let me circle back for just a minute. I want to make sure the record is clear, because I began to speed through when I realized my time is slipping away here.

It is our position that *Chevron* deference is a standard to be afforded to the reg, if you have to get to the reg, not *State Farm* reasoned analysis. And the reason for that is that this is a reg that interprets the statute. It doesn't -- it doesn't have a whole lot of empirical data behind it. There is a Supreme Court case, *Judulang*, Footnote 7. I think it's cited in our brief -- it may be cited in Microsoft's brief -- where the Supreme Court has essentially equated *Chevron* deference standard with -- Step 2 of that standard with *State Farm*

analysis, but then goes on to talk about it in that context; that they're going to apply *State Farm*, because the statute isn't really addressed in that case directly, the statute doesn't address what's at issue there.

The bottom line is this: This is a case that, unlike *State Farm* which involved passive restraint standards and oodles of data that were supposed to be considered by the Transportation Safety Board, or whatever it was, as to auto safety standards, this is about who's going to ask questions in an IRS interview?

And once again, Your Honor, let me just emphasize that this is a tremendously large audit. It's an important audit. The transfer pricing cases are important to the IRS. We want to get it right. The IRS told -- Microsoft told us, in 2011, that the analysis that was provided with its notice of proposed adjustments, with the IRS's notice of proposed adjustments, was arbitrary and capricious; that the informal interviews were of questionable utility. So Mr. Hoory and the transfer pricing operations folks have endeavored to do the best job they can, and they looked for assistance from Quinn Emanuel.

But let me go back to the analytic framework, Your Honor. If, in fact, Your Honor concurs -- and, you know, you listened to Mr. Hoory at length -- that there is a legitimate purpose here, then the summonses should be enforced, and we should move forward summarily. Now, I realize there may be particular

objections to privilege, or something like that, with some of the document requests, but the document requests should move forward, summarily. And with respect to the interviews, if Your Honor agrees that the statute is silent on this, that the statute, the summons statute, is an authority-granting statute, not a limiting statute, then there's no abuse of process to allow the interviews to go forward either.

So, Your Honor, I would urge that we get this summons enforcement proceeding case resolved as quickly as possible so that the IRS can do its job and try to do a fair and thorough audit, finish it up with respect to Microsoft's 2004 and 2006 tax years.

THE COURT: Mr. Weaver, thank you very, very much.

Ms. Eakes, as we discussed during our phone call earlier in the week, you have an opportunity for a short rebuttal.

MS. EAKES: Thank you.

Can we take just a couple of minutes so I can set back up the computer? Would that be okay?

THE COURT: You know, why don't we just go ahead and do that anyway. I think it's probably a good idea. But let's just take no more than ten minutes; all right?

MS. EAKES: Thank you, Your Honor.

(Recess)

THE COURT: All right. Counsel, we're back in session.

Ms. Eakes?

MS. EAKES: Thank you, Your Honor.

I first wanted to start with the issue that you raised right away with Mr. Weaver, about whether or not this is good policy, or whether they say it's good policy or bad policy.

And I guess the point I want to make about that is, I get -- Microsoft's point isn't necessarily that it's bad policy or good policy, because that's really not for us to decide. The issue is really what -- Congress is the one who sets policy, and what does Congress say about whether or not it's good policy or bad policy. So the IRS can say hiring outside counsel, getting people like Quinn Emanuel involved in an audit, is good policy. Well, and they may be right. We don't think it makes good policy. But, obviously, we would take a different position. The point is that they need to go and ask Congress for authorization to do that, because it really is Congress that sets the policy with respect to taxes and collections here in the U.S. So that was our point about it.

And I think if you look at the *Loving* case, which we cited in our reply brief, you will see that concept. Because in *Loving*, that was a case in which it was actually pretty clear that it was good policy, what the IRS was trying to do, but the Court found that it was not authorized by Congress. And that's our point with respect to what they've done here.

So I want to go back to 7602 and just address a couple of

points. First of all, Mr. Weaver said several times, "I don't think Microsoft disagrees that under 7602(a)(1) that contractors can examine under this provision." And, in fact, we do. And perhaps I didn't make that clear enough. Our position is that this language, under 7602(a)(1), and when it refers to "examine," they're not talking about look at getting assistance with contractors. This is a term of art, and they're talking about conducting the audit. And that's what this provision allows. And we -- and our position is that enforcing the summonses not only violates, with respect to the testimonial summonses, 7602(a)(3), but Quinn Emanuel's involvement in the audit, to the extent they're actually conducting the audit, or examining, under 7602(a)(1), is a violation of the statute, so just to make that clear.

Also, I just wanted to address the point that -- with respect to the distinction and why contractors can look at it. And that's under 6103, which is the statute that talks about confidentiality. It does allow the IRS to disclose tax return information to contractors. That's what that statute does. So that's the statute under which they can get help and give taxpayer information to somebody like an economist to assist them in conducting -- or in their audit function.

So if we look back at 6702 -- because the government had a lot to say about inherently governmental function. But the Court's analysis, in terms of the structure, which is what the

Court asked about, starts and ends with the statute, in our opinion. The question is whether or not 7602 is ambiguous. And it's not. I mean, on its plain language, it does not authorize contractors, people outside the government, to perform the functions, including taking testimony and conducting the audit.

And when I was up here before, the Court had asked a question about what "the Secretary" means, and whether or not there is an authorization for contractors there. But if you look at the term "the Secretary," it means the Secretary, the delegates, and it specifically says it means an officer, an employee, or an agency of the Treasury Department. So there's just simply nothing in 7602, combined with 7701, that says an outside contractor can do what the IRS is saying can be done here.

And the IRS made the point of, this is a statute that goes all the way back to the Civil War. Well, isn't it curious that in all that time, this has never been interpreted. There's nothing in the IRS files to say that 7602 and 7701 somehow meant that contractors can be involved in performing either under (a)(1) or (a)(3), or (a)(2) for that matter.

One other point I wanted to make with respect to the argument about inherently governmental functions is that the government is saying, "Well, asking questions isn't somehow an inherently governmental function." And again, you don't ever

get to the issue of inherently governmental function. That doesn't come into play when you first start and look at the statute and say that it's unambiguous. And they talk about the FAIR Act.

Sorry. I'm just trying to hop ahead here.

And the point I would make about that is, if you go back to the temporary regulation -- and I'm sorry. I don't have that up here on the screen right now. Let me see if I can find it.

Looking back at the temporary regulation, I mean, there was a lot of discussion by Mr. Weaver about what exactly an inherently governmental function means. But I'd point out that when you look at what they said in the temporary regulation, the IRS at that point, even though they're saying now that fact-gathering is outside of it, outside of inherently governmental functions, and that's all that asking questions is about, but what they said at the time of the temporary regulation is that inherently governmental functions, including deciding -- included deciding what information was supposed to be produced. And again, asking questions is -- that's exactly what you're doing. You're just asking the person to produce the information, and you're asking them to produce it verbally.

I think there's also -- in the case law that Mr. Weaver cited, it's a distinct difference between going out and having somebody else perform surveys and collect information from

citizens. That is a nondiscretionary activity. We've got to keep in mind what we're talking about here is a sworn testimony under oath, where the government can compel somebody to come in -- and it's essentially a one-sided deposition that the IRS gets to take. And they don't even have to allow the representative from the other side to be able to ask questions. And the compulsion aspect is important, but so is the penalty. The fact of the matter is, under this statute, you're talking about a situation in which the government brings somebody in, and if they don't comply, there are civil and there are criminal penalties that could flow from that.

And I make that point also with respect to the question of -- or the issue that was raised by Mr. Weaver about the voluntary interviews. You know, that's really not relevant to the Court's analysis now, because what Microsoft chose to do, or permit in the course of the voluntary interviews, was completely different. Because, again, you're not -- you don't have compulsion, and you don't have the threat of contempt. And so that -- the fact that they were able to make it work at that point is entirely different from what they're asking for now. They're now asking you to say that 7602 -- that that statute says they can bring in any contractor, and they can bring somebody in under a subpoena, and they can allow that contractor to ask the person questions, under oath, with the threat of contempt, and that that is permissible under the

statute. And we just don't think it allows that.

I also want to make the distinction between the fact that there's a difference between improper purpose, which Mr. Weaver spent a lot of time talking about, and the fact that if you violate a statute, it's an abuse of process. And the law is pretty clear, I think, that abuse of process is not something that has been defined as only encompassing these certain things, but it's a distinct difference. We are arguing that there is an improper purpose here, but we're also arguing that there's an abuse of process, because you cause statutory violations under (a)(1) and (a)(3), as well as -- I think it's 7803 with respect to legal authority -- if you enforce these summonses. And that constitutes an abuse of process, and that's separate and apart from an improper purpose.

With respect to the comment -- the discussion about the notice and comment, I would just point out that there's a presumption that the APA applies, including the notice and comment, unless there's statutory language to the contrary. And there's nothing in the statute here that talks about it. And it's not meaningless to say that the IRS has to comply with notice and comment, because it's an important process in terms of a check on government. Also, it doesn't render 780 -- I believe it's -- 7805(e) meaningless, because that is simply a sunsetting provision. And again, the IRS can continue to issue temporary regulations. There's no question about that. They

just need to be able to make a finding that there's good cause. And they do do that. But they're not absolved from the notice and comment provisions of the APA, and I think the case law is pretty clear on that.

I just wanted to talk for a second about the issue of the statute of limitations. One thing I failed to mention in my initial argument, and the Court asked some questions about the statute of limitations, is that it wasn't just a failure to tell us about Quinn Emanuel. There were affirmative misrepresentations that were made by the IRS in order to get the statute of limitations extension. And if you look at the Bernard declaration that I have on the screen, it talks about the fact that the IRS was telling them that consistent with their timeline -- which is what I already showed the Court -- the audit work was substantially completed, and they had quantified the alternative valuations, and that they would be producing supporting reports. So they were saying that the audit was over. This is what they told Microsoft in December of 2013. They never said that they weren't, until they came into court.

Also with respect to the extension, if you look at Mr. Sample's declaration -- and he talks about this December status call. Again, Mr. Hoory told Mr. Sample, during that time, that he would give the alternative valuation model for the APAC cost-sharing arrangement within several weeks after

the January meeting. So once again, we have representations that they're done, and that they actually had the numbers -- or had reached the conclusions that they're now saying they haven't reached.

I want to quickly address the *PAA Management* case that the the IRS cited. And we agree that if there's a mixed purpose, the summonses are unenforceable. But this isn't a case -- this situation isn't one in which there's a mixed purpose. And I think that the quote that we included in our brief about the distinction that the *PAA* case is drawing is important; that -- Judge Learned Hand's distinction between whether an IRS summons seeking information to support a new audit amount, which is proper, and one seeking evidence in support of that amount, which he said was improper.

And that's what the distinction is that we're talking about here. We're not talking about the IRS trying to get to a number. We're talking about the IRS -- and I think they essentially said as much in the course of Mr. Weaver's argument and when Mr. Hoory testified. They're trying to get information to support their number so that they can win in court. And that's an improper purpose under the *PAA* case.

That's really all I have to say, unless the Court has any questions.

I just think -- well, actually, I should check to make sure.

The final thing I wanted to address just very quickly is the issue about legal counsel. Because Mr. Weaver said, "Well, the statute doesn't say that they can only get advice from the Chief Counsel." And I think, in fact, it does. If you look at 7803(b), it does say that the Chief Counsel shall report -- sorry. I've got the wrong slide up there. I apologize.

What I wanted to point the Court to is the Department of the Treasury General Counsel Order Number 4. I think it's clear from the delegation order, which is the controlling document, that the Chief Counsel is the legal adviser to the commissioner of the IRS. So that is clear within both the statute, I think, when you read the statute in conjunction with this general Treasury order, that that's where they get their legal advice from.

Sorry. One note.

Oh, I'm sorry. The point I guess I was supposed to make was that the statute incorporates the delegation order. So when you read those in concert, you see that the legal advice has to come from Chief Counsel. And again, enforcing these summonses, they've already received advice from Quinn Emanuel, received legal advice from Quinn Emanuel. And the Court can't do anything about that going back. But certainly going forward, if you enforce these summonses, it will continue to be -- further the violation of the statute.

Final thing I would say, Your Honor, is, just, when you

think about the statute and what it means, and you're sorting it out, I think that the key thing that struck me, as I listened to Mr. Weaver, is that what they didn't really address, and they don't talk about, is that -- the great expansion that this really is, if you read the statute in the way that they say. You're talking about a statute that we think clearly says that this power, which is immense, is limited to the Secretary and the delegates, meaning the employees of the IRS.

The IRS is taking a big step, a huge step, when they say that actually incorporates contractors, and now the statute authorizes us to basically hand it all off to contractors. I don't think that's a fair reading of the statute. I don't think that's what public policy says. And I think *U.S. Telecom* is the cleanest case on that, as well as the statute, when you look at it. That's not what Congress intended. Congress did not intend to use this power -- to give this power and say it can simply be handed off. And I don't think that we're alone in our interpretation of it, because that's why Congress and Senator Hatch is writing a letter. That's why people are concerned. This will change the status quo dramatically, if the Court finds that this statute allows contractors to be included within the meaning of 7602.

Thank you.

THE COURT: Counsel, thank you very much.

All right. I want to thank my lower bench for their willingness to stay through our lunch hour.

And my standard practice, as I think both sides know, is to take your comments here at oral argument, review your briefing, and take another look at the cases that have been cited. I certainly understand that both sides want a quick resolution to the issue, and we will attempt to get that to you as soon as we possibly can.

Thank you very much. We'll be at recess.

(Adjourned)

C E R T I F I C A T E

I, Andrea Ramirez, RPR, CRR, Court Reporter for the United States District Court in the Western District of Washington at Seattle, do hereby certify that I was present in court during the foregoing matter and reported said proceedings stenographically.

I further certify that thereafter, I have caused said stenographic notes to be transcribed under my direction and that the foregoing pages are a true and accurate transcription to the best of my ability.

Dated this 16th day of November, 2015.

/s/ *Andrea Ramirez*

Andrea Ramirez
Official Court Reporter